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No. 08-1396

In The

Supreme Court of the United States

THE COFFEE BEANERY, LTD., ET AL.,

Petitioners,

v.

WW, LLC; RICHARD WELSHANS;
AND DEBORAH WILLIAMS,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

In *Hall Street Associates, L.L.C.* v. *Mattel, Inc.*, 552 U.S. ___, 128 S. Ct. 1396 (2008), this Court held that § 10 of the Federal Arbitration Act (FAA), 9 U.S.C. § 10, provides the "exclusive" grounds for vacating an arbitration award under the FAA. Since *Hall Street*, federal and state courts have divided over whether manifest disregard of the law—a ground that is not listed in § 10—remains a valid ground for vacating an arbitrator's award under the FAA. The First and Fifth Circuits have concluded that the doctrine is no longer valid. The Second, Seventh, and Ninth Circuits have concluded that the doctrine survives as a judicial gloss on § 10—but each court has crafted a different standard for the doctrine. The Sixth Circuit in the decision below and in a prior published opinion, *Dealer Computer Services, Inc.* v. *Dub Herring Ford*, 547 F.3d 558, 561 n.2 (CA6 2008), took yet a third position, concluding in direct conflict with *Hall Street* that the doctrine of manifest disregard provides another ground, in addition to the grounds provided by § 10, for vacating an arbitration award. The decision below vacated an arbitration award solely on that basis. App. 7-10.

The questions presented for review in this case are:

1. Is manifest disregard of the law a valid common-law or statutory ground for vacating an arbitration award under the Federal Arbitration Act?

QUESTIONS PRESENTED – Continued

2. Did the Sixth Circuit err in vacating the arbitration award in this case for manifest disregard of the law?

RULE 14.1(b) AND RULE 29.6 STATEMENT

The complete list of parties to the proceeding in the Sixth Circuit are Petitioners The Coffee Beanery Ltd., Joanne Shaw, Julius Shaw, Kevin Shaw, Kurt Shaw, Ken Coxen, Walter Pilon, and Owen Stern, and Respondents WW, LLC; Richard Welshans; and Deborah Williams.

The Coffee Beanery Ltd.'s parent company is Shaw Coffee Company. No publicly held company owns 10% or more of Shaw Coffee Company's stock.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
RULE 14.1(b) AND RULE 29.6 STATEMENT	iii
TABLE OF CONTENTS	iv
TABLE OF AUTHORITIES	vi
OPINIONS BELOW	1
JURISDICTION	1
STATUTE INVOLVED	2
STATEMENT	3
A. The Federal Arbitration Act	5
B. Factual Background	7
C. Decisions Of The Lower Courts	11
REASONS FOR GRANTING THE PETITION	15
I. The Opinion Below Implicates A Deep, Square Conflict In The Circuits Over Whether Manifest Disregard Of The Law Is A Valid Ground For Vacating An Arbitration Award Under The Federal Arbitration Act	15
A. In the First and Fifth Circuits, manifest disregard of the law is no longer a valid ground for vacating an arbitration award under the FAA	17
B. The Sixth Circuit holds that manifest disregard continues to exist as a non-statutory ground for vacating arbitration awards	19

TABLE OF CONTENTS – Continued

Page

C. The Second, Seventh, and Ninth Circuits construe manifest disregard as a gloss on FAA § 10(a)(4) but disagree on what falls within the doctrine 19

D. The divide in the Circuits is ripe for this Court's intervention 23

II. The Decisions That Continue To Apply The Doctrine Of Manifest Disregard Of The Law Are In Substantial Tension, If Not Outright Conflict, With *Hall Street* 24

III. Allowing Courts To Review Arbitration Awards For Legal Error Through The Doctrine Of Manifest Disregard Undermines Arbitration's Core Benefits Of Finality And Efficiency 28

IV. This Case Is An Ideal Vehicle For Deciding The Questions Presented 31

CONCLUSION 36

APPENDIX

Amended Opinion Of The Sixth Circuit ..... App. 1

Original Opinion Of The Sixth Circuit ..... App. 16

Opinion Of The District Court ..... App. 30

Award Of Arbitrator ..... App. 50

Opinion And Order Of The District Court Denying Reconsideration ..... App. 59

Order Of The Sixth Circuit Denying Panel Rehearing And Rehearing En Banc ..... App. 65

TABLE OF AUTHORITIES

Page

FEDERAL CASES

14 Penn Plaza LLC v. *Pyett*, 556 U.S. ___, 129 S. Ct. 1456 (2009) 25

Advest, Inc. v. *McCarthy*, 914 F.2d 6 (CA1 1990) 26

ALS & Assocs. v. *AGM Marine Constructors, Inc.*, 557 F. Supp. 2d 180 (D. Mass. 2008) 18

Apache Bohai Corp. LDC v. *Texaco China BV*, 480 F.3d 397 (CA5 2007) 26

B.L. Harbert Int'l, LLC v. *Hercules Steel Co.*, 441 F.3d 905 (CA11 2006) 27, 29

Barnes v. *Logan*, 122 F.3d 820 (CA9 1997) 32

Buckeye Check Cashing, Inc. v. *Cardegna*, 546 U.S. 440 (2006) 15, 31, 35, 36

Carter v. *Health Net of Cal., Inc.*, 374 F.3d 830 (CA9 2004) 22

Choice Hotels Int'l, Inc. v. *SM Prop. Mgmt., LLC*, 519 F.3d 200 (CA4 2008) 26

Circuit City Stores, Inc. v. *Adams*, 532 U.S. 105 (2001) 28

Citigroup Global Mkts. Inc. v. *Bacon*, 562 F.3d 349 (CA5 2009) ..... *passim*

Coady v. *Ashcraft & Gerel*, 223 F.3d 1 (CA1 2000) 32

Collins v. *D.R. Horton, Inc.*, 505 F.3d 874 (CA9 2007), *cert. denied*, 128 S. Ct. 1739 (2008) 21

TABLE OF AUTHORITIES – Continued

Page

Comedy Club, Inc. v. *Improv W. Assocs.*, 553 F.3d 1277 (CA9 2009) ..... *passim*

Dealer Computer Servs., Inc. v. *Dub Herring Ford*, 547 F.3d 558 (CA6 2008) 4, 14, 15, 19, 25

Dominion Video Satellite, Inc. v. *Echostar Satellite, L.L.C.*, 430 F.3d 1269 (CA10 2005) 27

Duferco Int'l Steel Trading v. *T. Klaveness Shipping A/S*, 333 F.3d 383 (CA2 2003) 26

E. Associated Coal Corp. v. *United Mine Workers*, 531 U.S. 57 (2000) 32

Eljer Mfg., Inc. v. *Kowin Dev. Corp.*, 14 F.3d 1250 (CA7 1994) 32

Ethyl Corp. v. *United Steelworkers of Am. AFL-CIO-CLC*, 768 F.2d 180 (CA7 1985) 30

George Watts & Son, Inc. v. *Tiffany & Co.*, 248 F.3d 577 (CA7 2001) 21, 27, 32

Halim v. *Great Gatsby's Auction Gallery, Inc.*, 516 F.3d 557 (CA7 2008) 4, 16, 21

Hall Street Associates, L.L.C. v. *Mattel, Inc.*, 552 U.S. ___, 128 S. Ct. 1396 (2008) ..... *passim*

Improv W. Assocs. v. *Comedy Club, Inc.*, 129 S. Ct. 45 (2008) 24

Jonites v. *Exelon Corp.*, 522 F.3d 721, *cert. denied*, 129 S. Ct. 198 (2008) 21

Kanuth v. *Prescott, Ball & Turben, Inc.*, 949 F.2d 1175 (CADC 1991) 27

TABLE OF AUTHORITIES – Continued

Page

Kyocera Corp. v. *Prudential-Bache T Servs.*, 341 F.3d 987 (CA9 2003) (en banc).....22, 24, 27

Lebron v. *Nat'l R.R. Passenger Corp.*, 513 U.S. 374 (1995).....12

Luong v. *Circuit City Stores, Inc.*, 368 F.3d 1109 (CA9 2004).....22, 26

Martik Bros. v. *Kiebler Slippery Rock, LLC*, No. 08cv1756, 2009 WL 1065893 (W.D. Pa. Apr. 20, 2009).....16

Martin Marietta Materials, Inc. v. *Bank of Okla.*, 304 Fed. Appx. 360 (CA6 2008).....17

McGrann v. *First Albany Corp.*, 424 F.3d 743 (CA8 2005).....26

Med. Shoppe Int'l, Inc. v. *Simmonds*, No. 4:08CV90, 2009 WL 367703 (E.D. Mo. Feb. 11, 2009).....16

Merrill Lynch, Pierce, Fenner & Smith, Inc. v. *Jaros*, 70 F.3d 418 (CA6 1995).....26

Mitsubishi Motors Corp. v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985).....29

N.J. Carpenters Funds v. *Prof'l Furniture Servs.*, No. 3:08-cv-3690, 2009 WL 483849 (D.N.J. Feb. 25, 2009).....17

Preston v. *Ferrer*, 552 U.S. ___, 128 S. Ct. 978 (2008).....28

Prime Therapeutics LLC v. *Omnicare, Inc.*, 555 F. Supp. 2d 993 (D. Minn. 2008).....16

TABLE OF AUTHORITIES – Continued

Page

Qorvis Commc'ns, LLC v. *Wilson*, 549 F.3d 303 (CA4 2008) 22, 23

Ramos-Santiago v. *United Parcel Serv.*, 524 F.3d 120 (CA1 2008) 4, 15, 18

Roadway Package Sys., Inc. v. *Kayser*, 257 F.3d 287 (CA3 2001) 26

Rodriguez de Quijas v. *Shearson/Am. Express, Inc.*, 490 U.S. 477 (1989) 25

Stolt-Nielsen SA v. *AnimalFeeds Int'l Corp.*, 548 F.3d 85 (CA2 2008) 4, 16, 17, 20, 33

Va. Bankshares, Inc. v. *Sandberg*, 501 U.S. 1083 (1991) 12

Volk v. *X-Rite, Inc.*, 599 F. Supp. 2d 1118 (S.D. Iowa 2009) 16

Wilko v. *Swan*, 346 U.S. 427 (1953) 25

Wise v. *Wachovia Sec., LLC*, 450 F.3d 265 (CA7 2006) 20, 31

STATE CASES

Hereford v. *D.R. Horton, Inc.*, No. 1070396, 2009 WL 104666 (Ala. Jan. 9, 2009) 17

People v. *Ainsworth*, 495 N.W.2d 177 (Mich. Ct. App. 1992) 35

People v. *Parcha*, 575 N.W.2d 316 (Mich. Ct. App. 1997) 35

Schinnerer v. *Md. Ins. Admin.*, 809 A.2d 709 (Md. Ct. Spec. App. 2002) 34

TABLE OF AUTHORITIES – Continued

Page

FEDERAL STATUTES AND RULES

9 U.S.C. § 1 *et seq.* 2

9 U.S.C. § 9 .....2, 3, 5, 6

9 U.S.C. § 10 .....*passim*

9 U.S.C. § 10(a)(4).....*passim*

28 U.S.C. § 1254(1).....1

S. Ct. R. 10(a).....4

S. Ct. R. 10(c).....4

STATE STATUTE

Md. Code Ann., Bus. Reg. § 14-216(c)(8)(i).....11, 34

OTHER AUTHORITIES

Christopher R. Drahozal, *Codifying Manifest Disregard*, 8 NEV. L.J. 234 (2007) 30

Stephen L. Hayford, *Reining in the "Manifest Disregard" of the Law Standard: The Key to Restoring Order to the Law of Vacatur*, 1998 J. DISP. RESOL. 117 28

Michael H. LeRoy & Peter Feuille, *Happily Never After: When Final and Binding Arbitration Has No Fairy Tale Ending*, 13 HARV. NEGOT. L. REV. 167 (2008) 29

PETITION FOR A WRIT OF CERTIORARI

Petitioners respectfully ask this Court to grant their petition for a writ of certiorari to review the decision and judgment of the United States Court of Appeals for the Sixth Circuit.

OPINIONS BELOW

The first opinion of the Sixth Circuit (App. 16-29), issued August 18, 2008, is unpublished. The amended opinion of the Sixth Circuit (App. 1-15), issued November 14, 2008, is unpublished and is reported at 300 Fed. Appx. 415. The order denying rehearing and rehearing *en banc* (App. 65-66) is unpublished. The published opinion of the district court (App. 30-49) is reported at 501 F. Supp. 2d 955. The unpublished order of the district court denying rehearing (App. 59-64) is unreported.

JURISDICTION

The Sixth Circuit entered judgment on August 18, 2008, then issued an amended judgment on November 14, 2008. Petitioners filed a timely petition for rehearing and rehearing *en banc*. The Sixth Circuit denied the petition on February 9, 2009. Petitioners invoke the jurisdiction of this Court under 28 U.S.C. § 1254(1).

STATUTE INVOLVED

The questions presented in this petition arise from the Federal Arbitration Act, 9 U.S.C. §§ 1-16, and in particular from sections 9 and 10 of the Act:

> § 9. Award of arbitrators; confirmation; jurisdiction; procedure. If the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration, and shall specify the court, then at any time within one year after the award is made any party to the arbitration may apply to the court so specified for an order confirming the award, and thereupon the court must grant such an order unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title. If no court is specified in the agreement of the parties, then such application may be made to the United States court in and for the district within which such award was made. . . .
>
> * * *
>
> § 10. Same; vacation; grounds; rehearing.
>
> (a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—
>
> (1) where the award was procured by corruption, fraud, or undue means;

> (2) where there was evident partiality or corruption in the arbitrators, or either of them;
>
> (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or
>
> (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.
>
> * * *

9 U.S.C. §§ 9, 10.

STATEMENT

The Sixth Circuit's decision below directly conflicts with this Court's holding in *Hall Street Associates, L.L.C.* v. *Mattel, Inc.*, 552 U.S. ___, 128 S. Ct. 1396 (2008), and contributes to a deep, post-*Hall Street* split in the circuits over whether manifest disregard of the law survives in any form as a ground for vacating arbitration awards under the FAA. *Hall Street* holds that § 10 of the Federal Arbitration Act "provide[s] the FAA's exclusive grounds for expedited vacatur." *Id.* at 1403. The Sixth Circuit nonetheless

held in a published opinion that a court may "vacate an award on *non-statutory* grounds if the arbitration panel demonstrates a 'manifest disregard of the law,'" citing this Court's *Hall Street* decision as a "*[b]ut see*" reference. *Dealer Computer Servs., Inc.* v. *Dub Herring Ford*, 547 F.3d 558, 561 n.2 (CA6 2008) (emphasis added). In the decision below, the Sixth Circuit repeated its rule that the grounds listed in § 10 are "*almost* exclusive[]" and held that courts "may *also* vacate an award found to be in manifest disregard of the law." App. 8 (emphases added). The Sixth Circuit's direct conflict with this Court's decision is itself a sufficient basis for granting review. S. Ct. R. 10(c).

The Sixth Circuit's decision also contributes to a deep, square circuit split on the validity and scope of the doctrine of manifest disregard. Two circuits have held or concluded that the doctrine of manifest disregard of the law does not survive *Hall Street*. *See Ramos-Santiago* v. *United Parcel Serv.*, 524 F.3d 120, 124 n.3 (CA1 2008); *Citigroup Global Mkts. Inc.* v. *Bacon*, 562 F.3d 349, 358 (CA5 2009). Three others have held that it does survive as a judicial gloss on § 10—but they disagree on its scope. *See Stolt-Nielsen SA* v. *AnimalFeeds Int'l Corp.*, 548 F.3d 85, 94 (CA2 2008); *Halim* v. *Great Gatsby's Auction Gallery, Inc.*, 516 F.3d 557, 563-64 (CA7 2008); *Comedy Club, Inc.* v. *Improv W. Assocs.*, 553 F.3d 1277, 1281 (CA9 2009). The Court should grant review to resolve the conflict in the circuits. S. Ct. R. 10(a).

This case presents the ideal vehicle for reviewing the doctrine of manifest disregard of the law. The doctrine was the sole basis for the Sixth Circuit's decision below. App. 7-11. Petitioners presented, and the Sixth Circuit rejected, the arguments that manifest disregard of the law is not a valid ground for vacating an arbitration award under the FAA and that, whatever the doctrine is, it does not provide a basis for vacating the award in this case. Moreover, the Sixth Circuit's decision illustrates perfectly the danger of allowing courts to review arbitration awards for legal error. Claiming to have found a legal error in the arbitrator's interpretation of Maryland franchise law, the Sixth Circuit invalidated an arbitration award that was in fact fully consistent with the Maryland statute. The Court should grant review to reverse the judgment of the Sixth Circuit, resolve the divide in the circuits, and hold that manifest disregard of the law is not a basis for vacating an arbitration award under the FAA.

A. The Federal Arbitration Act.

Sections 9 and 10 of the Federal Arbitration Act establish the grounds for enforcing and vacating arbitration awards, respectively. Section 9 provides that, if the parties agreed to judicial enforcement of the arbitration award, a "court *must* grant" an order enforcing the award "*unless* the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title." 9 U.S.C. § 9 (emphases added).

Section 10 states that courts may vacate an award for one of four reasons:

> (1) where the award was procured by corruption, fraud, or undue means;
>
> (2) where there was evident partiality or corruption in the arbitrators, or either of them;
>
> (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or
>
> (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

9 U.S.C. § 10.

In *Hall Street*, this Court held that the grounds provided by § 10 are the "exclusive grounds for expedited vacatur" under the FAA. 128 S. Ct. at 1403. The petitioner in *Hall Street* argued that the "statutory grounds for prompt vacatur and modification may be supplemented by contract." *Id.* at 1400. But the Court disagreed. It held that the statutory grounds cannot be supplemented because "the text compels a reading of the §[ ]10 . . . categories as exclusive." *Id.* at 1404. As the Court explained, "the three provisions, §§ 9-11,

. . . substantiat[e] a national policy favoring arbitration with just the limited review needed to maintain arbitration's essential virtue of resolving disputes straightaway." *Id.* at 1405 (internal quotation marks and citations omitted). "Any other reading opens the door to the full-bore legal and evidentiary appeals that can rende[r] informal arbitration merely a prelude to a more cumbersome and time-consuming judicial review process and bring arbitration theory to grief in post-arbitration process." *Ibid.* (internal quotation marks and citations omitted).

B. Factual Background.

In June 2003, respondent Richard Welshans entered a franchise agreement with Coffee Beanery. Coffee Beanery is a national franchisor of specialty coffee businesses that is headquartered in Michigan. Welshans' franchise agreement with Coffee Beanery contained a broad arbitration provision under which the parties agreed that

> any claim or controversy arising out of or related to this Agreement, or the making, performance, breach, interpretation, or termination thereof, shall be finally settled by arbitration pursuant to the then-prevailing Commercial Arbitration Rules of the American Arbitration Association or any successor thereto, by one arbitrator appointed in accordance with such rules. . . . The arbitration award shall be binding upon the parties and

> may be entered and enforced in any court of competent jurisdiction.

The parties excluded four enumerated categories of claims from the agreement to arbitrate, but none of the exclusions applies here. Two months after Welshans signed the franchise agreement, he assigned it to respondent WW, LLC, which Welshans owns together with respondent Deborah Williams (collectively, Respondents). Respondents opened and began to operate a Coffee Beanery café in Annapolis, Maryland.

This case arose when Respondents failed to succeed as a Coffee Beanery franchisee. Blaming Coffee Beanery for their failure, Respondents first demanded arbitration in January 2005, then changed positions and refused to arbitrate. They filed a complaint in the United States District Court for the District of Maryland against not only Coffee Beanery but also several of its officers, Petitioners Joanne Shaw, Julius Shaw, Kevin Shaw, Kurt Shaw, Ken Coxen, Walter Pilon, and Owen Stearn (collectively, "Coffee Beanery" or Petitioners). Coffee Beanery, in turn, filed a motion to compel arbitration in the United States District Court for the Eastern District of Michigan. The parties agreed to stay the Maryland action pending a ruling on the motion to compel arbitration. In July 2006, the district court for the Eastern District of Michigan granted Coffee Beanery's motion to compel arbitration. App. 5.

After the district court compelled arbitration, Coffee Beanery reached an agreement for a Consent Order with the Securities Commissioner of Maryland. App. 6. The Commissioner had commenced an investigation of Coffee Beanery related to Respondents' allegations. Under the Consent Order, Coffee Beanery was required to offer rescission to Respondents but was also entitled to "deny any statement of fact or conclusion of law of the Consent Order in any proceeding, litigation, or arbitration against them in which the Commissioner is not a party." App. 6. Coffee Beanery made the offer of rescission, but Respondents did not accept it.

In January 2007, Respondents arbitrated their claims against Coffee Beanery in an eleven-day hearing. At the conclusion of the hearing, the arbitrator issued a written award rejecting all of Respondents' claims and entering an award for Coffee Beanery. App. 51-52. The only claim relevant to this petition is Respondents' contention that Coffee Beanery violated Maryland's Franchise Registration and Disclosure Law by failing to disclose that one of its officers, Kevin Shaw, had previously been convicted of the felony of larceny for stealing traffic cones with a college buddy. Shaw's testimony at the arbitration hearing, which was the only the relevant evidence in the record, was the following:

> Q. Mr. Shaw, have you ever been convicted of a crime involving theft or dishonesty?
>
> A. Yes, I have.

> Q. And what was that crime?
>
> A. When I was in college, I was out with a buddy of mine and we were driving down the road picking up construction cones and throwing them in the back seat of the car, and we continued to drive down the road until the police officer saw all the orange construction cones in the back of the car and he stopped us and asked us what we were doing with them.
>
> We were—it was a stupid college thing to do.
>
> * * *
>
> Q. You were charged with grand larceny.
>
> A. Yes. It was over a hundred dollars so it was considered grand larceny.

The arbitrator considered Shaw's testimony, applied the relevant provisions of the Maryland statute, and concluded that Shaw's conviction was not the type of conviction that Maryland law requires a franchisor to disclose. App. 56. Maryland law requires franchisors to disclose to prospective franchisees only convictions for felonies that involved fraud, a breach of trust, or some type of dishonesty. Specifically, they must disclose whether

> any person identified in the prospectus has been convicted of a felony, [or] has pleaded nolo contendere to a felony charge . . . , if the felony . . . involved fraud, embezzlement, fraudulent conversion or misappropriation of property. . . .

Md. Code Ann., Bus. Reg. § 14-216(c)(8)(i). The arbitrator held that Kevin Shaw's conviction did not fall within this statute, reasoning:

> The Arbitrator finds that Respondent was not required to disclose to Claimants that Kevin Shaw has a felony conviction for grand larceny as it is not the type of felony conviction subject to disclosure. Michigan and Maryland franchise laws limit such disclosure to felonies that involve fraud, embezzlement, fraudulent conversion, or misappropriation of property.

App. 56.

C. Decisions Of The Lower Courts.

The United States District Court for the Eastern District of Michigan confirmed the arbitrator's award on Coffee Beanery's and Respondents' cross motions to confirm and vacate the award, respectively. App. 49. The district court's opinion does not address whether the arbitrator acted in manifest disregard of the law by concluding that Coffee Beanery was not required to disclose Kevin Shaw's conviction under § 14-216(c)(8)(i) of the Maryland Franchise Registration and Disclosure Law because Respondents did not initially argue the point. Respondents raised the argument in their motion to reconsider the district

court's order, which the district court denied.[1] App. 64.

On appeal, the Sixth Circuit issued an initial opinion on August 18, 2008, reversing the judgment of the district court and vacating the arbitration award solely on the ground that the arbitrator manifestly disregarded the law by holding that Coffee Beanery was not required to disclose Shaw's conviction. App. 24, 29. The Sixth Circuit exercised its discretion to address the question of manifest disregard "[b]ecause it is a pure question of law" and "there are no facts in dispute regarding this issue." App. 25. Indeed, manifest disregard of the law was the only issue the Sixth Circuit addressed:

> We begin and end with the very last argument, because we find it dispositive to the instant case. Because Shaw failed to disclose his prior felony conviction for grand larceny in violation of the Franchise Act, Md. Bus. Reg. Code Ann. § 14-216(c)(8)(i), we conclude that the Arbitrator's award shows a manifest disregard of the law.

App. 24. The court's entire rationale for finding manifest disregard by the arbitrator was its declaration that "misappropriation of property" "by definition

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[1] Because the Sixth Circuit addressed the question of manifest disregard on the merits, the question is squarely presented for this Court. *See Va. Bankshares, Inc.* v. *Sandberg*, 501 U.S. 1083, 1099 n.8 (1991); *Lebron* v. *Nat'l R.R. Passenger Corp.*, 513 U.S. 374, 379 (1995).

would include a conviction for grand larceny, regardless of the conduct giving rise to the conviction." App. 26. The Sixth Circuit did not cite any Maryland case adopting its definition of "misappropriation of property." It nonetheless found that "the Arbitrator's contrary interpretation—that Shaw was not required to disclose this felony in the offering prospectus—fl[ies] in the face of clearly established legal precedent." App. 27 (internal quotation marks omitted). Because it found that Coffee Beanery had failed to make a statutorily required disclosure, it held that Respondents "need not resort to arbitration to vindicate [their] statutory rights but may instead seek appropriate relief in a court of law." App. 29. The court therefore remanded the case for litigation.

Coffee Beanery moved for rehearing and rehearing *en banc* on the ground that the Sixth Circuit's opinion directly contradicted this Court's decision in *Hall Street*. In response, the Sixth Circuit withdrew its original opinion and issued an amended opinion on November 14, 2008, that directly addresses whether manifest disregard of the law continues to exist as a valid common-law ground for vacating an arbitration award after *Hall Street*. App. 1, 8-10. The court noted that "[s]ection 10 of the FAA sets forth the statutory grounds to vacate an arbitration award" and held that its authority to vacate an arbitration award is "*almost* exclusively limited to these grounds," but that it "may also vacate an award found to be in manifest disregard of the law." App. 8 (emphasis added). An award is in manifest disregard, the court

held, if "(1) the applicable legal principle is clearly defined and not subject to reasonable debate; and (2) the arbitrators refused to heed that legal principle." App. 9. Addressing *Hall Street*, the Sixth Circuit held that "the Supreme Court significantly reduced the ability of federal courts to vacate arbitration awards for reasons other than those specified in 9 U.S.C. § 10, but it did not foreclose federal courts' review for an arbitrator's manifest disregard of the law." *Ibid.* The court concluded that "it would be imprudent to cease employing such a universally recognized principle" and decided that it would "follow its well-established precedent here and continue to employ the 'manifest disregard' standard." App. 10; *see also Dealer Computer Servs.*, 547 F.3d at 561 n.2. The Sixth Circuit then repeated verbatim its initial analysis concluding that the arbitrator had manifestly disregarded the law and remanded for litigation. App. 10-15.

Coffee Beanery again moved for rehearing and rehearing *en banc*, arguing that the Sixth Circuit's application of the manifest disregard of the law standard conflicted with *Hall Street*. On February 9, 2009, the Sixth Circuit denied the petition. App. 65-66.

REASONS FOR GRANTING THE PETITION

I. The Opinion Below Implicates A Deep, Square Conflict In The Circuits Over Whether Manifest Disregard Of The Law Is A Valid Ground For Vacating An Arbitration Award Under The Federal Arbitration Act.

Congress enacted the FAA "[t]o overcome judicial resistance to arbitration" and create a uniform, "national policy favoring arbitration." *Buckeye Check Cashing, Inc.* v. *Cardegna*, 546 U.S. 440, 443 (2006). The Circuits' treatment of the doctrine of manifest disregard of the law, however, has been anything but uniform. Since this Court's decision in *Hall Street Associates, L.L.C.* v. *Mattel, Inc.*, 552 U.S. ___, 128 S. Ct. 1396 (2008), the Circuits have divided at least three ways over whether manifest disregard of the law—a ground for vacatur that is not listed in FAA § 10—remains a valid ground for vacating an arbitrator's award under the FAA. The First and Fifth Circuits have concluded that manifest disregard is a judicially created doctrine and thus is no longer a valid basis for vacating an award after *Hall Street*. *Ramos-Santiago* v. *United Parcel Serv.*, 524 F.3d 120, 124 n.3 (CA1 2008); *Citigroup Global Mkts. Inc.* v. *Bacon*, 562 F.3d 349, 358 (CA5 2009). The Sixth Circuit has taken the polar opposite view, agreeing that the manifest disregard doctrine is a judicially created doctrine, but holding that it remains a legitimate ground for vacating an award. App. 8-10; *Dealer Computer Servs., Inc.* v. *Dub Herring Ford*, 547 F.3d

558, 561 n.2 (CA6 2008). The Second and Ninth Circuits have concluded that the manifest disregard doctrine survives as a judicial gloss on section 10 of the FAA, *Stolt-Nielsen SA* v. *AnimalFeeds Int'l Corp.*, 548 F.3d 85, 94 (CA2 2008); *Comedy Club, Inc.* v. *Improv W. Assocs.*, 553 F.3d 1277, 1281 (CA9 2009), a position that the Seventh Circuit had already taken before *Hall Street*, *see Halim* v. *Great Gatsby's Auction Gallery, Inc.*, 516 F.3d 557, 563-64 (CA7 2008). Each court, however, has crafted a separate standard for the doctrine.[2]

Several courts have acknowledged the conflict among the circuits. The Fifth Circuit recognized the split between the First and Second, Sixth, and Ninth Circuits, and joined the First Circuit. *Citigroup*, 562 F.3d at 355-58. The Second Circuit likewise recognized that, since *Hall Street*, some courts "have concluded or suggested that the doctrine simply does not survive," while "[o]thers think that 'manifest disregard,' reconceptualized as a judicial gloss on the

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[2] Federal district courts in circuits that have not yet addressed the issue are also divided. *Compare, e.g.*, *Prime Therapeutics LLC* v. *Omnicare, Inc.*, 555 F. Supp. 2d 993, 999 (D. Minn. 2008) (concluding that, after *Hall Street*, "courts can no longer vacate an arbitration award based on judicially-created grounds such as 'manifest disregard of the law' "); *Med. Shoppe Int'l, Inc.* v. *Simmonds*, No. 4:08CV90, 2009 WL 367703, at *3 (E.D. Mo. Feb. 11, 2009) (same); *Martik Bros.* v. *Kiebler Slippery Rock, LLC*, No. 08cv1756, 2009 WL 1065893, at *2 n.2 (W.D. Pa. Apr. 20, 2009) (same), *with Volk* v. *X-Rite, Inc.*, 599 F. Supp. 2d 1118, 1125-32 (S.D. Iowa 2009) (reviewing an arbitral award for manifest disregard).

specific grounds for vacatur enumerated in section 10 of the FAA, remains a valid ground for vacating arbitration awards." *Stolt-Nielsen*, 548 F.3d at 94. The Sixth and Ninth Circuits, as well as several district and state courts, have also recognized the conflict. *See, e.g.*, *Martin Marietta Materials, Inc.* v. *Bank of Okla.*, 304 Fed. Appx. 360, 362-63 (CA6 2008); *Comedy Club*, 553 F.3d at 1290; *N.J. Carpenters Funds* v. *Prof'l Furniture Servs.*, No. 3:08-cv-3690, 2009 WL 483849, at *4 n.1 (D.N.J. Feb. 25, 2009); *Hereford* v. *D.R. Horton, Inc.*, No. 1070396, 2009 WL 104666, at *5 n.1 (Ala. Jan. 9, 2009).

The Court should grant review in this case to resolve the conflict in the Circuits and to give a single, national answer to the question whether manifest disregard of the law is a valid common-law or statutory ground for vacating an arbitration award under § 10 of the FAA.

A. In the First and Fifth Circuits, manifest disregard of the law is no longer a valid ground for vacating an arbitration award under the FAA.

After *Hall Street*, two circuits have concluded that manifest disregard of the law is no longer a valid ground under the FAA for vacating an arbitration award. In *Citigroup Global Markets Inc.* v. *Bacon*, the Fifth Circuit held that "manifest disregard of the law as an independent, nonstatutory ground for setting aside an award must be abandoned and rejected" and

that "from this point forward, arbitration awards under the FAA may be vacated only for reasons provided in § 10." 562 F.3d at 358. "Indeed," the court declared, "the term itself, as a term of legal art, is no longer useful in actions to vacate arbitration awards." *Ibid.* Because the district court had vacated an arbitration award for manifest disregard of the law, the Fifth Circuit vacated the decision and remanded for review under the standard announced in § 10 of the FAA. In its decision in *Ramos-Santiago v. United Parcel Service*, the First Circuit took the same position. A party defending an arbitration award issued in a labor dispute asked the First Circuit to hold that manifest disregard of the law is no longer a valid ground for vacating an award under the National Labor Relations Act. 524 F.3d at 124-25 & n.3. Addressing the argument, the First Circuit declared that, after *Hall Street*, "manifest disregard of the law is not a valid ground for vacating or modifying an arbitral award in cases brought under the" FAA. *Id.* at 124 n.3. The court found it unnecessary, however, to decide whether the same was true of the NLRA. District courts in the First Circuit have applied *Ramos-Santiago* as controlling authority that abrogates the doctrine of manifest disregard in FAA cases. *See, e.g., ALS & Assocs.* v. *AGM Marine Constructors, Inc.*, 557 F. Supp. 2d 180, 185 (D. Mass. 2008).

B. The Sixth Circuit holds that manifest disregard continues to exist as a non-statutory ground for vacating arbitration awards.

In direct conflict with the First and Fifth Circuits, the Sixth Circuit has held that the doctrine of manifest disregard of the law survives as a common-law doctrine that exists in addition to and apart from the grounds listed in § 10 of the FAA. Citing this Court's *Hall Street* decision as a "*[b]ut see*" reference, the Sixth Circuit held in *Dealer Computer Services* that a court may "vacate an award on *non-statutory* grounds if the arbitration panel demonstrates a 'manifest disregard of the law.'" 547 F.3d at 561 n.2 (emphasis added; parallel citations omitted). In the decision below, the Sixth Circuit applied the same rule, explaining that manifest disregard is a standard separate from the statutory standards for vacatur in § 10(a) and is a separate ground for vacating an award. App. 8-10. As discussed above, the court acknowledged this Court's decision in *Hall Street* but concluded that "it did not foreclose federal courts' review for an arbitrator's manifest disregard of the law." App. 9.

C. The Second, Seventh, and Ninth Circuits construe manifest disregard as a gloss on FAA § 10(a)(4) but disagree on what falls within the doctrine.

In conflict with the First, Fifth, and Sixth Circuits, the Second, Seventh, and Ninth Circuits

construe manifest disregard as a judicial gloss on FAA § 10(a)(4), which allows courts to vacate an award if the "arbitrators exceeded their powers." 9 U.S.C. § 10(a)(4). Each circuit, however, has adopted a different rule of what manifest disregard includes, creating further conflict in the law.

Although the Second Circuit before *Hall Street* had repeatedly described "the 'manifest disregard' standard as a ground for vacatur entirely separate from those enumerated in the FAA," *Stolt-Nielsen*, 548 F.3d at 94, that court nevertheless held that *Hall Street* "did not, we think, abrogate the 'manifest disregard' doctrine altogether," *id.* at 95. Instead, the Second Circuit agreed with courts holding that "'manifest disregard,' reconceptualized as a judicial gloss on the specific grounds for vacatur enumerated in section 10 of the FAA, remains a valid ground for vacating arbitration awards." *Id.* at 94. Under the Second Circuit's test, a legal error can be the ground for vacating an arbitration award "[i]f the arbitrator's decision strains credulity or does not rise to the standard of barely colorable." *Id.* at 92-93 (internal quotation marks and brackets omitted). According to the Second Circuit, when arbitrators so act, they have "exceeded their powers" under § 10(a)(4) of the FAA. *Id.* at 95.

The Seventh Circuit, even before *Hall Street*, "defined 'manifest disregard of the law' so narrowly that it fits comfortably under the first clause of the fourth statutory ground—'where the arbitrators exceeded their powers.'" *Wise* v. *Wachovia Sec., LLC*,

450 F.3d 265, 268 (CA7 2006) (Posner, J.). In the Seventh Circuit, "the 'manifest disregard' principle is limited to two possibilities: an arbitral order requiring the parties to violate the law . . . , and an arbitral order that does not adhere to the legal principles specified by contract, and hence unenforceable under § 10(a)(4)." *George Watts & Son, Inc.* v. *Tiffany & Co.*, 248 F.3d 577, 581 (CA7 2001) (Easterbrook, J.). An arbitrator who "rules that a particular Com Ed worker is required to work during mealtimes, but that it is such easy work that it is undeserving of the minimum wage, let alone of overtime," and thus orders the parties to violate the overtime provisions of the Fair Labor Standards Act going forward, provides an example of the first possibility. *Jonites* v. *Exelon Corp.*, 522 F.3d 721, 726 (CA7), *cert. denied*, 129 S. Ct. 198 (2008). An arbitrator who "ignor[es] a choice of law provision in an arbitration agreement" provides an example of the second possibility. *Halim*, 516 F.3d at 564. In conflict with the Second Circuit, the Seventh Circuit holds that "[f]actual or legal error, no matter how gross, is insufficient to support overturning an arbitration award." *Id.* at 563.

The Ninth Circuit, like the Second Circuit, has held that "an arbitrator's manifest disregard of the law remains a valid ground for vacatur of an arbitration award under § 10(a)(4)" after *Hall Street*. *Comedy Club*, 553 F.3d at 1281. Although earlier Ninth Circuit cases treated manifest disregard of the law as an extra-statutory ground for vacating an award, *see, e.g.*, *Collins* v. *D.R. Horton, Inc.*, 505 F.3d 874, 879

(CA9 2007), *cert. denied*, 128 S. Ct. 1739 (2008); *Carter* v. *Health Net of Cal., Inc.*, 374 F.3d 830, 837-38 (CA9 2004); *Luong* v. *Circuit City Stores, Inc.*, 368 F.3d 1109, 1112 (CA9 2004), the Ninth Circuit now takes the position that "the manifest disregard ground for vacatur is shorthand for a statutory ground under the FAA, specifically 9 U.S.C. § 10(a)(4), which states that the court may vacate 'where the arbitrators exceeded their powers.'" *Comedy Club*, 553 F.3d at 1290 (citing *Kyocera Corp.* v. *Prudential-Bache T Servs.*, 341 F.3d 987, 997 (CA9 2003) (*en banc*)). The Ninth Circuit's test for manifest disregard is whether it is "clear from the record that the arbitrator recognized the applicable law and then ignored it." *Id.* at 1290 (brackets and internal quotation marks omitted). In practice, the Ninth Circuit finds this standard met by a sufficiently clear legal error, such as when "[t]he grounds given by the arbitrator for disregarding [the applicable law] are fundamentally incorrect." *Id.* at 1293.

Finally, the Fourth Circuit has continued to apply the standard of manifest disregard in reviewing arbitration awards after *Hall Street* without addressing the authority for that approach. In *Qorvis Communications, LLC* v. *Wilson*, 549 F.3d 303 (CA4 2008), the court considered and rejected on its merits a freestanding argument that "the arbitrator manifestly disregarded the law of damages," without addressing whether manifest disregard was a valid, nonstatutory ground for vacating an award. *Id.* at 311. The *Qorvis* court separately considered and rejected

an argument that the arbitrator had exceeded his powers under § 10(a)(4) of the FAA by making a legal error, concluding that it is the court's "role to review the correctness of the arbitrator's reasoning only if the arbitrator 'irrationally' disregarded the terms of the contract." *Id.* at 312. By considering on the merits an argument that arbitrators had manifestly disregarded the law in their rulings, it appears that the Fourth Circuit has implicitly joined those circuits that have held that the "manifest disregard" standard for vacatur of arbitration awards survives *Hall Street*. It is unclear, however, whether the Fourth Circuit regards the "manifest disregard" standard as a "judicial gloss" on § 10 of the FAA in line with the Second, Seventh, or Ninth Circuits, or whether it agrees with the Sixth Circuit that the statutory grounds for vacatur in the FAA are not exclusive.

D. The divide in the Circuits is ripe for this Court's intervention.

There is no benefit to allowing this issue to percolate further in the lower courts. The circuit split is deep, and it will not resolve without intervention by this Court. The Circuits have considered both this Court's decision and their own precedent, and have concluded that their respective positions are binding in their circuits. The Sixth Circuit, in the decision below, said that it was following "its well-established precedent" and denied rehearing *en banc*, indicating that the issue is settled. App. 10. The Fifth Circuit acknowledged the divide in the circuits and held that

"manifest disregard of the law as an independent, nonstatutory ground for setting aside an award must be abandoned and rejected." *Citigroup*, 562 F.3d at 356. The Ninth Circuit reached its position after this Court vacated its original decision and remanded for reconsideration in light of *Hall Street*. *See Improv W. Assocs.* v. *Comedy Club, Inc.*, 129 S. Ct. 45 (2008). On remand, the court held that it was bound by its *en banc* precedent in *Kyocera* because "[we] cannot say that *Hall Street Associates* is 'clearly irreconcilable' with *Kyocera*." *Comedy Club*, 553 F.3d at 1290. Until this Court intervenes, parties to arbitration agreements will encounter different sets of rules in the federal courts, based solely on where their arbitrations are held.

II. The Decisions That Continue To Apply The Doctrine Of Manifest Disregard Of The Law Are In Substantial Tension, If Not Outright Conflict, With *Hall Street*.

The Sixth Circuit's decision below directly conflicts with this Court's holding in *Hall Street*. *Hall Street* holds that § 10 of the Federal Arbitration Act "provide[s] the FAA's exclusive grounds for expedited vacatur." 128 S. Ct. at 1403. Yet in the decision below, the Sixth Circuit held that the grounds listed in § 10 are "*almost* exclusive[]" and concluded that it could "*also* vacate an award found to be in manifest disregard of the law." App. 9 (emphases added). The Sixth Circuit reached the same conclusion in an earlier, published opinion, where it held that a court

may "vacate an award on *non-statutory* grounds if the arbitration panel demonstrates a 'manifest disregard of the law.'" *Dealer Computer Servs.*, 547 F.3d at 561 n.2 (emphasis added). In the decision below, the Sixth Circuit also continued to rely on the comments regarding "manifest disregard" in *Wilko* v. *Swan*, 346 U.S. 427, 436 (1953), in direct conflict with this Court's rejection of those comments in *Hall Street*. App. 8. As *Hall Street* recognized, *Wilko*'s comments on manifest disregard were dicta. Its only holding "was that § 14 of the Securities Act of 1933 voided any agreement to arbitrate claims of violations of that Act." 128 S. Ct. at 1403. (And that holding was overruled by *Rodriguez de Quijas* v. *Shearson/American Express, Inc.*, 490 U.S. 477, 484-85 (1989).) The petitioner in *Hall Street* argued that *Wilko* "recogniz[ed] 'manifest disregard of the law' as a further ground for vacatur on top of those listed in § 10," and contended that, "if judges can add grounds to vacate (or modify), so can contracting parties." *Id.* at 1403. But the Court rejected this argument, saying that "this is too much for *Wilko* to bear" and holding that "now that [the] meaning" of *Wilko*'s dictum is "implicated, we see no reason to accord it the significance that Hall Street urges." *Id.* at 1404. Earlier this Term, the Court further undermined *Wilko* when it wrote that, in light of the "radical change" in the Court's receptivity to arbitration, "reliance on *any* judicial decision . . . littered with *Wilko*'s overt hostility to the enforcement of arbitration agreements would be ill advised." *14 Penn Plaza LLC* v. *Pyett*, 556

U.S. ___, 129 S. Ct. 1456, 1470 (2009) (emphasis added).

The decisions of the Second and Ninth Circuits holding that manifest disregard of the law continues to exist as a "judicial gloss" on § 10 are also in substantial tension, if not outright conflict, with *Hall Street*. *Hall Street* held that the "categories" listed in § 10 for vacating an award are "exclusive," 128 S. Ct. at 1404, and manifest disregard is not among those categories. Before *Hall Street*, all of the Courts of Appeals but one recognized that manifest disregard of the law was extra-statutory. *See, e.g.*, *Advest, Inc.* v. *McCarthy*, 914 F.2d 6, 9 n.5 (CA1 1990) (describing manifest disregard review as a "judicially created" ground for vacatur); *Duferco Int'l Steel Trading* v. *T. Klaveness Shipping A/S*, 333 F.3d 383, 388-89 (CA2 2003) (a ground in "addition to the grounds afforded by statute," used only "where none of the provisions of the FAA apply"); *Roadway Package Sys., Inc.* v. *Kayser*, 257 F.3d 287, 291 n.2 (CA3 2001) (an "additional, nonstatutory bas[i]s"); *Choice Hotels Int'l, Inc.* v. *SM Prop. Mgmt., LLC*, 519 F.3d 200, 207 (CA4 2008) (a "common law ground[]"); *Apache Bohai Corp. LDC* v. *Texaco China BV*, 480 F.3d 397, 405 (CA5 2007) ("a non-statutory ground"); *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Jaros*, 70 F.3d 418, 421 (CA6 1995) ("an alternative to the[] statutory grounds, a separate judicially created basis for vacation"); *McGrann* v. *First Albany Corp.*, 424 F.3d 743, 749 (CA8 2005) (a basis "[i]n addition to" statutory grounds); *Luong*, 368 F.3d at 1112 (CA9 2004)

(manifest disregard is "a non-statutory escape valve")[3]; *Dominion Video Satellite, Inc.* v. *Echostar Satellite, L.L.C.*, 430 F.3d 1269, 1275 (CA10 2005) ("a judicially-created basis"); *B.L. Harbert Int'l, LLC* v. *Hercules Steel Co.*, 441 F.3d 905, 910 (CA11 2006) (a "nonstatutory ground[ ]"); *Kanuth* v. *Prescott, Ball & Turben, Inc.*, 949 F.2d 1175, 1178 (CADC 1991) (a ground "in addition to the statutory grounds"). It is difficult, if not impossible, to reconcile the Circuits' pre-*Hall Street* treatment of the doctrine of manifest disregard of the law as extra-statutory with their conclusion that it nonetheless continues to survive post-*Hall Street*. The one circuit that escapes the tension is the Seventh Circuit, which properly refused to apply the doctrine to allow judicial review for legal error even before *Hall Street* and vacated awards only if the arbitrators exceeded their powers under § 10(a)(4) of the FAA, such as by applying a law different than the ones the parties selected, ordering the parties to violate the law, or deciding an issue outside their scope of authority. *See, e.g.*, *George Watts & Son*, 248 F.3d at 581.

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[3] In addition to characterizing manifest disregard as a non-statutory doctrine, the Ninth Circuit at other times called it a statutory doctrine. *See, e.g.*, *Kyocera Corp.* v. *Prudential-Bache T Servs.*, 341 F.3d 987, 997 (CA9 2003) (*en banc*) (arbitrators "exceed their powers" under § 10(a)(4) when they exhibit manifest disregard of the law).

III. Allowing Courts To Review Arbitration Awards For Legal Error Through The Doctrine Of Manifest Disregard Undermines Arbitration's Core Benefits Of Finality And Efficiency.

The question whether manifest disregard of the law is a valid ground for vacating an arbitration award under the FAA warrants this Court's review because of the sweeping national consequences it has for the continued vitality of arbitration. More than any other ground for vacating an award, manifest disregard threatens to undermine arbitration's chief virtues of finality and efficiency by smuggling judicial review for legal errors into the FAA's expedited confirmation process.

One effect of allowing manifest disregard to introduce judicial review for legal errors is as obvious as it is destructive: it "rob[s] the [arbitral] process of its most essential feature—finality—by giving parties disappointed with the result reached in arbitration reason to believe they may be able to circumvent objectionable awards by resort to the courts." Stephen L. Hayford, *Reining in the "Manifest Disregard" of the Law Standard: The Key to Restoring Order to the Law of Vacatur*, 1998 J. DISP. RESOL. 117, 118. Arbitration is supposed "to achieve 'streamlined proceedings and expeditious results,'" *Preston* v. *Ferrer*, 552 U.S. ___, 128 S. Ct. 978, 986 (2008), as well as "allow parties to avoid the costs of litigation," *Circuit City Stores, Inc.* v. *Adams*, 532 U.S. 105, 123 (2001). It does none of these things if it is "merely a prelude to a more

cumbersome and time-consuming judicial review process." *Hall Street*, 128 S. Ct. at 1405. Already, courts are experiencing a "spurt of cases" challenging arbitration awards. Michael H. LeRoy & Peter Feuille, *Happily Never After: When Final and Binding Arbitration Has No Fairy Tale Ending*, 13 HARV. NEGOT. L. REV. 167, 205 (2008) (summarizing results from empirical study of challenges to awards in arbitration between individual employees and employers). Some courts have been driven to open frustration by the number of parties who, having lost in arbitration, turn to manifest disregard in an effort to gain legal review of the arbitrator's decision. The Eleventh Circuit remarked "that this Court is exasperated by those who attempt to salvage arbitration losses through litigation that has no sound basis in the law applicable to arbitration awards." *B.L. Harbert Int'l*, 441 F.3d at 914. And it warned "that in order to further the purposes of the FAA and to protect arbitration as a remedy we are ready, willing, and able to consider imposing sanctions in appropriate cases." *Ibid.* Better for this Court to clarify the law than for lower courts to attempt to enforce an unclear standard through sanctions.

Just as troubling as the litigation that manifest review can add to the end of the arbitral process is the corruption it can cause of the process itself. "By agreeing to arbitrate," parties are supposed to be able to "trade[ ] the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration." *Mitsubishi Motors Corp.* v.

Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628 (1985). But judicial review for legal error puts irresistible pressure on arbitrators to produce awards that they can defend against legal review, thereby sacrificing the cost-effectiveness and informality that attract parties to arbitration in the first place. Arbitrators faced with legal review by courts will demand greater briefing from the parties, hold longer hearings, spend more time researching the issues, and write longer, more formal decisions—in a word, they will become more like courts. *See Hall Street*, 128 S. Ct. at 1405 (citing *Ethyl Corp.* v. *United Steelworkers of Am. AFL-CIO-CLC*, 768 F.2d 180, 184 (CA7 1985)). By the process of reviewing arbitral awards for legal error, "the very foundations of the institution of arbitration are eaten away." Christopher R. Drahozal, *Codifying Manifest Disregard*, 8 NEV. L.J. 234, 246 (2007).

Inefficiency, heightened formality, increased costs, and eroded finality cannot be the path forward under the FAA. As Judge Posner wrote for the Seventh Circuit:

> It is tempting to think that courts are engaged in judicial review of arbitration awards under the Federal Arbitration Act, but they are not. When parties agree to arbitrate their disputes they opt out of the court system, and when one of them challenges the resulting arbitration he perforce does so not on the ground that the arbitrators made a mistake but that they violated the agreement to arbitrate, as by corruption, evident

> partiality, exceeding their powers, etc.—conduct to which the parties did not consent when they included an arbitration clause in their contract.

Wise, 450 F.3d at 269 (citation omitted).

IV. This Case Is An Ideal Vehicle For Deciding The Questions Presented.

This case cleanly presents the question whether manifest disregard of the law is a valid common-law or statutory ground for vacating an arbitration award under the FAA. Nothing in the history or procedural posture of the case will hinder or limit the Court's review.

First, all of the members of this Court will be able to address the question presented on its merits because the proceedings below were in federal court, not in a state court. *See*, *e.g.*, *Buckeye Check Cashing*, 546 U.S. at 449 (Thomas, J., dissenting) ("I remain of the view that the Federal Arbitration Act (FAA), 9 U.S.C. § 1 *et seq.*, does not apply to proceedings in state courts.").

Second, manifest disregard of the law was the sole basis for the Sixth Circuit's decision. The district court denied Respondents' motion to vacate the arbitration award and confirmed the award in favor of Coffee Beanery. App. 49. The Sixth Circuit reversed the district court and vacated the award, basing its decision entirely on its conclusion that the arbitrator's award evidenced a manifest disregard of the law.

App. 10-11. As Judge Cole wrote for the panel, "[w]e begin and end with" manifest disregard of the law, "because we find it dispositive to the instant case." App. 11. The Sixth Circuit also directly addressed *Hall Street* and concluded that it "did not foreclose federal courts' review for an arbitrator's manifest disregard of the law." App. 9. In so reasoning, the Sixth Circuit has laid all of the necessary groundwork for this Court to determine whether courts should continue to recognize the doctrine of manifest disregard—whether construed as an extra-statutory basis for vacatur under the FAA or as a "gloss" on the "exceeded their discretion" clause of § 10(a)(4).

The facts of this case also position it at the point of the Circuits' disagreement. The arbitrator here did not resolve a claim outside the scope of the agreement,[4] apply a different body of law than the arbitration agreement made applicable,[5] or order the parties to do something that violated the law[6]—actions that all Circuits would agree would exceed the arbitrator's

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[4] *See, e.g.*, *Coady* v. *Ashcraft & Gerel*, 223 F.3d 1 (CA1 2000) (deciding an issue that parties had already resolved by agreement); *Eljer Mfg., Inc.* v. *Kowin Dev. Corp.*, 14 F.3d 1250, 1256 (CA7 1994) (awarding relief against nonparty to arbitration agreement).

[5] *See, e.g.*, *Barnes* v. *Logan*, 122 F.3d 820, 823 (CA9 1997) (applying California law, where arbitration agreement contained Minnesota choice-of-law provision).

[6] *See, e.g.*, *George Watts & Son*, 248 F.3d at 580-81 (dictum), *citing E. Associated Coal Corp.* v. *United Mine Workers*, 531 U.S. 57 (2000).

powers under § 10(a)(4) of the FAA. Instead, the arbitrator correctly identified the governing Maryland franchise law, applied it to the evidence presented at the arbitration, and concluded that the law did not require disclosure of the type of conviction at issue. App. 56. The Sixth Circuit vacated the arbitrator's award simply because it concluded that the arbitrator had made a clear legal error. App. 12-14.

If the Court does not grant review in this case, it risks being unable to address the issue for lack of another good vehicle. The time for seeking review in this Court has already passed for the decisions of the First, Fourth, and Seventh Circuits discussed above without a petition for a writ of certiorari being filed. A petition for certiorari is pending before this Court seeking review of the Second Circuit's decision in *Stolt-Nielsen*, No. 08-1198 (Mar. 26, 2009), but it seeks review only of an unrelated question regarding class arbitration, likely because vehicle problems exist on the issue of manifest disregard of the law. *See Stolt-Nielsen*, 548 F.3d at 97 (noting that Stolt-Nielsen had "assured the [arbitration] panel that the [choice-of-law] issue was immaterial," and holding that "[t]his concession bars us from concluding that the panel manifestly disregarded the law by not engaging in a choice-of-law analysis"). The Fifth Circuit's decision in *Citigroup* remands the case to the district court for further analysis whether the arbitration award can be vacated on grounds other than manifest disregard, placing it in an interlocutory posture and raising the possibility that the case

will be resolved on alternative, independently sufficient grounds. *Citigroup*, 562 F.3d at 358. The time has not yet run for the losing party to seek review of the Ninth Circuit's decision in *Comedy Club*, but that case does not present the question whether manifest disregard of the law survives as a common-law doctrine. 553 F.3d at 1290. This case, in contrast, cleanly presents the complete question whether manifest disregard is a valid common-law or statutory ground for vacating an arbitration award under the FAA.

In addition, the result in this case demonstrates how little protection the doctrine of manifest disregard provides against courts finding manifest error even in close cases. Here, the arbitrator's interpretation of Maryland law was, if anything, better supported than the interpretation adopted by the Sixth Circuit. The issue of Maryland law was whether convictions for larceny fall within the category of convictions for "misappropriation of property," which the Maryland Franchise Registration and Disclosure Law requires franchisors to disclose, Md. Code Ann., Bus. Reg. § 14-216(c)(8)(i). The arbitrator held that they do not, App. 56, and her conclusion is well-supported by Maryland law because "misappropriation" requires an element of dishonesty, whereas larceny contains no such element. Under Maryland law, "misappropriation of property" is defined as the "application of another's property or money *dishonestly* to one's own use." *Schinnerer* v. *Md. Ins. Admin.*, 809 A.2d 709, 719 (Md. Ct. Spec. App. 2002) (emphasis added). There was no element of

dishonesty in Shaw's Michigan conviction for larceny, either factually or legally. *See People* v. *Ainsworth*, 495 N.W.2d 177, 178 (Mich. Ct. App. 1992); *People* v. *Parcha*, 575 N.W.2d 316, 321 (Mich. Ct. App. 1997). The Sixth Circuit, in contrast, cited no Maryland decision concluding that "misappropriation of property" includes "larceny." App. 13-14. It simply declared that the arbitrator was wrong—a result that demonstrates the clear threat to arbitration that is posed by the doctrine of manifest disregard.

Finally, after the Sixth Circuit incorrectly vacated the arbitration award for manifest disregard of the law, it compounded its error by remanding for litigation "in a court of law" instead of for further proceedings in arbitration. App. 15. Under this Court's decision in *Buckeye Check Cashing*, where a party disputes a contract's validity "but not specifically its arbitration provisions, those provisions are enforceable apart from the remainder of the contract. The challenge should therefore be considered by an arbitrator, not a court." 546 U.S. at 446. Here, Respondents did not specifically dispute the validity of the arbitration provision, so the Sixth Circuit should have remanded for further arbitration proceedings, not litigation. The questions whether manifest disregard continues to be a valid ground for vacating an arbitration award, and whether the Sixth Circuit erred in finding manifest disregard in this case, are logically antecedent to any question about what the Court should order on remand under *Buckeye*. Hence, the Sixth Circuit's *Buckeye* error does not create any

impediment to reviewing the questions presented. Granting review would, however, give the Court the opportunity to craft its own order on remand to be consistent with *Buckeye*.

CONCLUSION

The petition for a writ of certiorari should be granted.

Dated: May 11, 2009

Respectfully submitted,

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COFFEE BEANERY, LTD., et al.,
Petitioners-Appellees,
v.
WW, L.L.C.; Deborah Williams; and Richard Welshans, Respondents-Appellants.
No. 07-1830.

Nov. 14, 2008.

On Appeal from the United States District Court for the Eastern District of Michigan.

BEFORE: COLE and CLAY, Circuit Judges; RUSSELL, District Judge.*

AMENDED OPINION

COLE, Circuit Judge.

Respondent-Appellant WW, L.L.C. and its two principal owners, Richard Welshans and Deborah Williams (collectively, "WW"), appeal the district court's denial of their motion to vacate an arbitration award. At issue is whether the Arbitrator showed a manifest disregard of the law when she issued her award. Because we conclude that the failure to disclose a prior felony conviction for grand larceny violates the Maryland Franchise Registration and

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* The Honorable Thomas B. Russell, United States District Judge for the Western District of Kentucky, sitting by designation.

Disclosure Law ("Franchise Act"), Md. Bus. Reg.Code Ann. § 14-216(8)(i), and because the Arbitrator showed a manifest disregard of the law in concluding otherwise, we **REVERSE** the judgment of the district court and **VACATE** the Arbitrator's award.

I. BACKGROUND

Petitioner-Appellee, The Coffee Beanery Ltd., is a Michigan corporation with its principal place of business in Flushing, Michigan. Its primary business is to sell and operate Coffee Beanery franchises across the United States. The remaining Petitioners-Appellees, Joanne Shaw, Julius Shaw, Kevin Shaw, Kurt Shaw, Ken Coxen, Walter Pilon, and Owen Stearn, are officers of the company (collectively, "the Coffee Beanery"). WW, L.L.C. is a Maryland corporation with its principal place of business in Annapolis, Maryland.

This dispute arises out of a failed business agreement to license a Coffee Beanery Cafe. In Spring of 2003, Richard Welshans and Deborah Williams, husband and wife, began researching the idea of opening a small coffee shop that would sell coffee and other beverages. The two arranged a meeting with Kevin Shaw, the Coffee Beanery's Vice President of Real Estate, to discuss the details of a purchase and a potential location for a store.

In June 2003, Richard and Deborah attended a Coffee Beanery "discovery day" at the headquarters in Flushing, Michigan to investigate the purchase of a

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WW never accepted the rescission offer. Instead, in January 2007, it submitted its claims to arbitration in Ann Arbor, Michigan. Arbitrator JoAnne Barron presided over an eleven-day hearing that included testimony from WW, other Cafe Store owners, and representatives from the Coffee Beanery. On March 28, 2007, the Arbitrator issued an award finding in favor of the Coffee Beanery on all claims.

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On June 4, 2007, WW sought reconsideration of the district court's opinion and order, which the district court denied. *Coffee Beanery v. WW L.L.C.*, No. 06-10408, 2007 WL 2335135 (E.D.Mich. Aug. 16, 2007) ("*Coffee Beanery III*"). WW timely appealed.

II. ANALYSIS

When reviewing a district court's decision to confirm an arbitration award, we review questions of law de novo and review findings of fact for clear error. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Jaros*, 70 F.3d 418, 420 (6th Cir.1995) (citing *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 947-48, 115 S.Ct. 1920, 131 L.Ed.2d 985 (1995)).

"The Federal Arbitration Act ('FAA') expresses a presumption that arbitration awards will be confirmed." *Nationwide Mut. Ins. Co. v. Home Ins. Co.*, 429 F.3d 640, 643 (6th Cir.2005). "'When courts are

called on to review an arbitrator's decision, the review is very narrow; [it is] one of the narrowest standards of judicial review in all of American jurisprudence.'" *Id.* (quoting *Lattimer-Stevens Co. v. United Steelworkers,* 913 F.2d 1166, 1169 (6th Cir.1990)). Section 10 of the FAA sets forth the statutory grounds to vacate an arbitration award; namely: (1) where the award was procured by corruption, fraud, or undue means; (2) where an arbitrator evidenced partiality or corruption; (3) where the arbitrators were guilty of misconduct; and (4) where the arbitrators exceeded their power. 9 U.S.C. § 10(a)(1)-(4).

This Court's ability to vacate an arbitration award is almost exclusively limited to these grounds, although it may also vacate an award found to be in manifest disregard of the law. *Wilko v. Swan,* 346 U.S. 427, 436, 74 S.Ct. 182, 98 L.Ed. 168 (1953) (overruled on other grounds by *Rodriguez de Quijas v. Shearson/Am. Express, Inc.,* 490 U.S. 477, 109 S.Ct. 1917, 104 L.Ed.2d 526 (1989)). In *Wilko,* the Supreme Court implicitly recognized judicial review based on "manifest disregard" of the law when it stated that "the interpretations of the law by the arbitrators *in contrast to manifest disregard* are not subject, in the federal courts, to judicial review for error in interpretation." 346 U.S. at 436, 74 S.Ct. 182 (emphasis added). To constitute a manifest disregard for the law, "[a] mere error in interpretation or application of the law is insufficient. Rather, the decision must fly in the face of clearly established legal precedent." *Jaros,*

70 F.3d at 421. Thus, an arbitrator acts with manifest disregard if "(1) the applicable legal principle is clearly defined and not subject to reasonable debate; and (2) the arbitrators refused to heed that legal principle." *Id.*

In *Hall Street Assocs., L.L.C. v. Mattel, Inc.*, ___ U.S. ___, 128 S.Ct. 1396, 170 L.Ed.2d 254 (2008), the Supreme Court significantly reduced the ability of federal courts to vacate arbitration awards for reasons other than those specified in 9 U.S.C. § 10, but it did not foreclose federal courts' review for an arbitrator's manifest disregard of the law. The Court held that the FAA does not allow *private parties* to supplement by contract the FAA's statutory grounds for vacatur of an arbitration award. *Id.* at 1400. Moreover, the Court rejected reading *Wilko* to allow any "general review for an arbitrator's legal errors." *Id.* at 1404. However, with respect to the judicially-invoked, narrow exception for an arbitrator's manifest disregard of the law, the Court acknowledged that "[m]aybe the term 'manifest disregard' [in *Wilko*] was meant to name a new ground for review," though it also suggested that narrower interpretations of *Wilko* were equally plausible. *Id.* at 1404. The Court did not come to a conclusion regarding the precise meaning of *Wilko,* holding only that *Wilko* could not be read to allow parties to expand the scope of judicial review by their own agreement. *Id.*

It is worth noting that since *Wilko,* every federal appellate court has allowed for the vacatur of an award based on an arbitrator's manifest disregard of

the law. *See Jaros,* 70 F.3d at 421; *see also McCarthy v. Citigroup Global Mkts., Inc.,* 463 F.3d 87, 91 (1st Cir.2006); *Hoeft v. MVL Group, Inc.,* 343 F.3d 57, 64 (2d Cir.2003); *Dluhos v. Strasberg,* 321 F.3d 365, 370 (3d Cir.2003); *Three S Delaware Inc. v. DataQuick Info. Sys., Inc.,* 492 F.3d 520, 527 (4th Cir.2007); *Prestige Ford v. Ford Dealer Computer Servs., Inc.,* 324 F.3d 391, 395-96 (5th Cir.2003); *Halim v. Great Gatsby's Auction Gallery, Inc.,* 516 F.3d 557, 563 (7th Cir.2008); *Manion v. Nagin,* 392 F.3d 294, 298 (8th Cir.2004); *Collins v. D.R. Horton, Inc.,* 505 F.3d 874, 879 (9th Cir.2007); *Dominion Video Satellite, Inc. v. Echostar Satellite L.L.C.,* 430 F.3d 1269, 1275 (10th Cir.2005); *Scott v. Prudential Sec., Inc.,* 141 F.3d 1007, 1017 (11th Cir.1998). In light of the Supreme Court's hesitation to reject the "manifest disregard" doctrine in all circumstances, we believe it would be imprudent to cease employing such a universally recognized principle. Accordingly, this Court will follow its well-established precedent here and continue to employ the "manifest disregard" standard.

WW raises four arguments in support of vacating the Arbitrator's award. First, the Arbitrator overreached her authority when she ruled on the Franchise Act claims. Second, the franchise agreement was unconscionable. Third, the Arbitrator had a conflict of interest that rose to the level of bias. Fourth, the Arbitrator manifestly disregarded the law. With regard to this last claim, WW contends that the Arbitrator ignored undisputed evidence that it was misled about certain promotions and contracts,

that Shaw made false representations about potential earnings, and that Shaw failed to disclose his prior felony conviction for grand larceny.

We begin and end with the very last argument, because we find it dispositive to the instant case. Because Shaw failed to disclose his prior felony conviction for grand larceny in violation of the Franchise Act, Md. Bus. Reg.Code Ann. § 14-216(8)(i), we conclude that the Arbitrator's award shows a manifest disregard of the law.

First, the fact that WW did not raise this claim before the district court until its motion for reconsideration does not defeat the claim on appeal. Although generally this Court will not consider an argument on appeal that was raised for the first time below in a motion for reconsideration, *see Am. Meat Inst. v. Pridgeon,* 724 F.2d 45, 47 (6th Cir.1984), "[t]his waiver rule is one of prudence . . . and [is] not jurisdictional," *Official Comm. of Unsecured Creditors of Color Tile, Inc. v. Coopers & Lybrand, LLP,* 322 F.3d 147, 159 (2d Cir.2003) (citation and quotation marks omitted). We have generally considered the following factors in determining whether we should exercise our discretion to hear a previously waived argument: (1) whether the question is one of law or one that requires some factual development; (2) whether the proper resolution of the issue is clear beyond doubt; (3) whether the failure to take up the issue will result in a miscarriage of justice; and (4) the parties' right to have their issues considered by both a district judge and an appellate court. *Scottsdale Ins. Co. v. Flowers,*

513 F.3d 546, 552-53 (6th Cir.2008) (citing *Friendly Farms v. Reliance Ins. Co.*, 79 F.3d 541, 545 (6th Cir.1996)). Because it is a pure question of law whether Shaw's failure to disclose his prior grand larceny conviction violated the Franchise Act, and because there are no facts in dispute regarding this issue, we believe it appropriate to consider this argument raised for the first time in WW's motion for reconsideration. *See also Marrero Pichardo v. Ashcroft*, 374 F.3d 46, 54 (2d Cir.2004). This is especially true because the Coffee Beanery, the party supposedly benefiting from the waiver rule, failed to even mention the waiver issue on appeal. *Flowers*, 513 F.3d at 553 (explaining that one of the important reasons for the waiver rule is to ensure fairness to the nonmoving litigant). *See also Lexicon, Inc. v. Safeco Ins. Co. of Am., Inc.*, 436 F.3d 662, 670 n. 6 (6th Cir.2006) (finding that issue raised for the first time in defendant's response to plaintiff's reply brief for summary judgment was not waived partly because both parties fully briefed the issue on appeal).

The Arbitrator found that the Coffee Beanery "was not required to disclose to [WW] that Kevin Shaw has a felony conviction for grand larceny as it is not the type of felony conviction subject to disclosure." We disagree. Under the Franchise Act, an offering prospectus must include "whether any person identified in the prospectus has been convicted of a felony . . . if the felony or civil action involved fraud, embezzlement, fraudulent conversion, or misappropriation of property." Md. Bus. Reg.Code Ann.

§ 14-216(8)(i). The language of this provision could not be any more clear: all persons identified in the offering prospectus must disclose any prior felony so long as it involves some "misappropriation of property," which by definition would include a conviction for grand larceny, regardless of the conduct giving rise to the conviction. *See, e.g., Benton v. Maryland,* 395 U.S. 784, 803, 89 S.Ct. 2056, 23 L.Ed.2d 707 (1969) (citing *Fletcher v. State,* 231 Md. 190, 189 A.2d 641 (1963)) ("Larceny in Maryland is a common-law crime, consisting of the taking and carrying away of the personal property of another with intent to deprive the owner of the property permanently."); Wayne R. LaFave, 3 Subst. Crim. L. § 19.2 (2007) ("Larceny at common law may be defined as the (1) trespassory (2) taking and (3) carrying away of the (4) personal property (5) of another (6) with intent to steal it.").

The result is that the Coffee Beanery and Shaw may be civilly liable to WW. The Franchise Act states, in no uncertain terms, that "[a] person who sells or grants a franchise is civilly liable to the person who buys or is granted a franchise if the person . . . by means of . . . any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading, if the person who buys or is granted a franchise does not know of the . . . omission." Md. Bus. Reg.Code Ann. § 14-227(a)(1)(ii). Thus, the Arbitrator's contrary interpretation – that Shaw was not required to disclose this felony in the

offering prospectus – "fl[ies] in the face of clearly established legal precedent." *Jaros,* 70 F.3d at 421.

Moreover, this is not the type of case in which the governing law has not been brought to the attention of the Arbitrator. *See id.* Instead, the record indicates that counsel for both parties generally agreed on the applicable law during arbitration (and still do on appeal). Indeed, the Coffee Beanery concedes that it failed to disclose Shaw's prior felony conviction, and argues only that it was not the type of conviction subject to disclosure under the Franchise Act.

True, we cannot say that the Arbitrator's conclusion that "the non-disclosure [of the felony] did not cause damage to Claimants" constitutes a refusal to heed a clearly defined legal principle. But we interpret this finding as relating to compensatory damages allowed for under the Franchise Act, *see* Md. Bus. Reg.Code Ann. § 14-227(b) ("The person who buys or is granted a franchise may sue under this section to recover damages sustained by the grant of the franchise."), and not relating to the question of whether WW is entitled to a rescission of the franchise agreement, *see id.* § 14-227(c) ("A court may order the person who sells or grants a franchise to: (1) rescind the franchise; and (2) make restitution to the person who buys or is granted a franchise."). Because the Arbitrator expressly chose not to follow clearly established law regarding the disclosure of Shaw's prior felony, we believe the issue of whether WW is entitled to a rescission is more appropriately

addressed when WW pursues its civil remedies available under the Franchise Act in a court of law.

Finally, the purpose of this provision of the Franchise Act is to allow parties to make informed decisions regarding whether to enter into a franchise agreement and with whom they choose to do business. Because WW was deprived of a mandatory, statutorily required notice, prior into entering into the franchise agreement, and did not have an opportunity to avoid being subjected to the consequences of having entered into the contract (including the requirement to arbitrate such claims), WW should not be bound by the arbitration provisions of the agreement which it was fraudulently induced into signing in violation of the Franchise Act.

III. CONCLUSION

For those reasons, we **REVERSE** the judgment of the district court and **VACATE** the Arbitrator's award. Because the Coffee Beanery failed to disclose Shaw's felony conviction, WW need not resort to arbitration to vindicate its statutory rights but may instead seek appropriate relief in a court of law.

NOT RECOMMENDED FOR FULL-TEXT PUBLICATION

No. 07-1830

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

COFFEE BEANERY, LTD., ET AL., *Petitioners-Appellees,* v. **WW, L.L.C.; DEBORAH WILLIAMS; and RICHARD WELSHANS,** *Respondents-Appellants.*	ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF MICHIGAN **OPINION** (Filed Aug. 18, 2008)

BEFORE: COLE and CLAY, Circuit Judges; RUSSELL, District Judge.*

COLE, Circuit Judge. Respondent-Appellant WW, L.L.C. and its two principal owners, Richard Welshans and Deborah Williams (collectively, "WW"), appeal the district court's denial of their motion to vacate an arbitration award. At issue is whether the Arbitrator showed a manifest disregard of the law when she issued her award. Because we conclude that the failure to disclose a prior felony conviction for grand larceny violates the Maryland Franchise

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* The Honorable Thomas B. Russell, United States District Judge for the Western District of Kentucky, sitting by designation.

Registration and Disclosure Law ("Franchise Act"), Md. Bus. Reg. Code Ann. § 14-216(8)(i), and because the Arbitrator showed a manifest disregard of the law in concluding otherwise, we **REVERSE** the judgment of the district court and **VACATE** the Arbitrator's award.

I. BACKGROUND

Petitioner-Appellee, The Coffee Beanery Ltd., is a Michigan corporation with its principal place of business in Flushing, Michigan. Its primary business is to sell and operate Coffee Beanery franchises across the United States. The remaining Petitioners-Appellees, Joanne Shaw, Julius Shaw, Kevin Shaw, Kurt Shaw, Ken Coxen, Walter Pilon, and Owen Stearn, are officers of the company (collectively, "the Coffee Beanery"). WW, L.L.C. is a Maryland corporation with its principal place of business in Annapolis, Maryland.

This dispute arises out of a failed business agreement to license a Coffee Beanery Cafe. In Spring of 2003, Richard Welshans and Deborah Williams, husband and wife, began researching the idea of opening a small coffee shop that would sell coffee and other beverages. The two arranged a meeting with Kevin Shaw, the Coffee Beanery's Vice President of Real Estate, to discuss the details of a purchase and a potential location for a store.

In June 2003, Richard and Deborah attended a Coffee Beanery "discovery day" at the headquarters in Flushing, Michigan to investigate the purchase of

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Section 10 of the FAA sets forth the statutory grounds to vacate an arbitration award; namely: (1) where the award was procured by corruption, fraud, or undue means; (2) where an arbitrator evidenced partiality or corruption; (3) where the arbitrators were guilty of misconduct; and (4) where the arbitrators exceeded their power. 9 U.S.C. § 10(a)(1)-(4). This Court's ability to vacate an arbitration award is almost exclusively limited to these grounds, although an award found to be in manifest disregard of the law can also be vacated. *Wilko v. Swan*, 346 U.S. 427, 436 (1953) (overruled on other grounds by *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477 (1989)). To constitute a manifest disregard for the law, "[a] mere error in interpretation or application of the law is insufficient. Rather, the decision must fly in the face of clearly established legal precedent." *Jaros*, 70 F.3d at 421. Thus, an arbitrator acts with manifest disregard if "(1) the applicable legal principle is clearly defined and not

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WW raises four arguments in support of vacating the Arbitrator's award. First, the Arbitrator overreached her authority when she ruled on the Franchise Act claims. Second, the franchise agreement was unconscionable. Third, the Arbitrator had a conflict of interest that rose to the level of bias. Fourth, the Arbitrator manifestly disregarded the law. With regard to this last claim, WW contends that the Arbitrator ignored undisputed evidence that it was misled about certain promotions and contracts, that Shaw made false representations about potential earnings, and that Shaw failed to disclose his prior felony conviction for grand larceny.

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jurisdictional," *Official Comm. of Unsecured Creditors of Color Tile, Inc. v. Coopers & Lybrand, LLP*, 322 F.3d 147, 159 (2d. Cir. 2003) (citation and quotation marks omitted). We have generally considered the following factors in determining whether we should exercise our discretion to hear a previously waived argument: (1) whether the question is one of law or one that requires some factual development; (2) whether the proper resolution of the issue is clear beyond doubt; (3) whether the failure to take up the issue will result in a miscarriage of justice; and (4) the parties' right to have their issues considered by both a district judge and an appellate court. *Scottsdale Ins. Co. v. Flowers*, 513 F.3d 546, 552-53 (6th Cir. 2008) (citing *Friendly Farms v. Reliance Ins. Co.*, 79 F.3d 541, 545 (6th Cir. 1996)). Because it is a pure question of law whether Shaw's failure to disclose his prior grand larceny conviction violated the Franchse Act, and because there are no facts in dispute regarding this issue, we believe it appropriate to consider this argument raised for the first time in WW's motion for reconsideration. *See also Marrero Pichardo v. Ashcroft*, 374 F.3d 46, 54 (2d Cir. 2004). This is especially true because the Coffee Beanery, the party supposedly benefitting from the waiver rule, failed to even mention the waiver issue on appeal. *Flowers*, 513 F.3d at 553 (explaining that one of the important reasons for the waiver rule is to ensure fairness to the non-moving litigant). *See also Lexicon, Inc. v. Safeco Ins. Co. of Am., Inc.*, 436 F.3d 662, 670 n.6 (6th Cir. 2006) (finding that issue raised for the first time in defendant's response to plaintiff's

reply brief for summary judgment was not waived partly because both parties fully briefed the issue on appeal).

The Arbitrator found that the Coffee Beanery "was not required to disclose to [WW] that Kevin Shaw has a felony conviction for grand larceny as it is not the type of felony conviction subject to disclosure." We disagree. Under the Franchise Act, an offering prospectus must include "whether any person identified in the prospectus has been convicted of a felony . . . if the felony or civil action involved fraud, embezzlement, fraudulent conversion, or misappropriation of property." Md. Bus. Reg. Code Ann. § 14-216(8)(i). The language of this provision could not be any more clear: all persons identified in the offering prospectus must disclose any prior felony so long as it involves some "misappropriation of property," which by definition would include a conviction for grand larceny, regardless of the conduct giving rise to the conviction. *See, e.g., Benton v. Maryland*, 395 U.S. 784, 803 (1969) (citing *Fletcher v. State*, 189 A. 2d 641 (1963)) ("Larceny in Maryland is a common-law crime, consisting of the taking and carrying away of the personal property of another with intent to deprive the owner of the property permanently."); Wayne R. LaFave, 3 Subst. Crim. L. § 19.2 (2007) ("Larceny at common law may be defined as the (1) trespassory (2) taking and (3) carrying away of the (4) personal property (5) of another (6) with intent to steal it.").

The result is that the Coffee Beanery and Shaw may be civilly liable to WW. The Franchise Act states, in no uncertain terms, that "[a] person who sells or grants a franchise is civilly liable to the person who buys or is granted a franchise if the person . . . by means of . . . any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading, if the person who buys or is granted a franchise does not know of the . . . omission." Md. Bus. Reg. Code Ann. § 14-227(a)(1)(ii). Thus, the Arbitrator's contrary interpretation – that Shaw was not required to disclose this felony in the offering prospectus – "fl[ies] in the face of clearly established legal precedent." *Jaros*, 70 F.3d at 421.

Moreover, this is not the type of case in which the governing law has not been brought to the attention of the Arbitrator. *See id.* Instead, the record indicates that counsel for both parties generally agreed on the applicable law during arbitration (and still do on appeal). Indeed, the Coffee Beanery concedes that it failed to disclose Shaw's prior felony conviction, and argues only that it was not the type of conviction subject to disclosure under the Franchise Act.

True, we cannot say that the Arbitrator's conclusion that "the non-disclosure [of the felony] did not cause damage to Claimants" constitutes a refusal to heed a clearly defined legal principle. But we interpret this finding as relating to compensatory damages allowed for under the Franchise Act, *see* Md. Bus. Reg. Code Ann. § 14-227(b) ("The person who

buys or is granted a franchise may sue under this section to recover damages sustained by the grant of the franchise."), and not relating to the question of whether WW is entitled to a rescission of the franchise agreement, *see id.* § 14-227(c) ("A court may order the person who sells or grants a franchise to: (1) rescind the franchise; and (2) make restitution to the person who buys or is granted a franchise). Because the Arbitrator expressly chose not to follow clearly established law regarding the disclosure of Shaw's prior felony, we believe the issue of whether WW is entitled to a rescission is more appropriately addressed when WW pursues its civil remedies available under the Franchise Act in a court of law.

Finally, the purpose of this provision of the Franchise Act is to allow parties to make informed decisions regarding whether to enter into a franchise agreement and with whom they choose to do business. Because WW was deprived of a mandatory, statutorily required notice, prior into entering into the franchise agreement, and did not have an opportunity to avoid being subjected to the consequences of having entered into the contract (including the requirement to arbitrate such claims), WW should not be bound by the arbitration provisions of the agreement which it was fraudulently induced into signing in violation of the Franchise Act.

V. CONCLUSION

For those reasons, we **REVERSE** the judgment of the district court and **VACATE** the Arbitrator's award. Because the Coffee Beanery failed to disclose Shaw's felony conviction, WW need not resort to arbitration to vindicate its statutory rights but may instead seek appropriate relief in a court of law.

501 F.Supp.2d 955

United States District Court,
E.D. Michigan,
Southern Division.
The COFFEE BEANERY LTD., Joanne Shaw, Julius Shaw, Kevin Shaw, Kurt Shaw, Ken Coxen, Walter Pilon, and Owen Stearn, Petitioners,
v.
WW L.L.C., Deborah Williams, and Richard Welshans, Respondents.
No. 06-10408.

May 23, 2007.

OPINION AND ORDER

DUGGAN, District Judge.

Petitioners initiated this action to compel arbitration to resolve a dispute between themselves and respondents arising from a franchise agreement pursuant to which respondents purchased and operated a Coffee Beanery Cafe. Respondents thereafter sought to stay arbitration pending the outcome of administrative proceedings the Maryland Securities Commissioner brought against The Coffee Beanery Ltd. and Kevin Shaw. This Court denied respondents' request and the parties proceeded to arbitration in January 2007. On March 28, 2007, the arbitrator issued an arbitration award in favor of petitioners and against respondents. Presently before the Court is respondents' motion to vacate the arbitration award and petitioners' motion to confirm the award, filed April 18 and 20, 2007, respectively. This Court

issued a notice to the parties on May 15, 2007, informing them that it is dispensing with oral argument with respect to both motions pursuant to Eastern District of Michigan Local Rule 7.1(e)(2).

I. Factual and Procedural Background

The Coffee Beanery Ltd. ("Coffee Beanery") is a Michigan Corporation with its principal place of business in Flushing, Michigan. The remaining petitioners are officers of the Coffee Beanery and citizens of Michigan. The Coffee Beanery sells and operates Coffee Beanery franchises.

Respondent WW L.L.C. ("WW") is a Maryland corporation with its principal place of business in Annapolis, Maryland. Respondents Deborah Williams and Richard Welshans own WW and are Maryland citizens. In June 2003, Welshans received a "Uniform Franchise Offering Circular" ("UFOC") from the Coffee Beanery and a copy of the Coffee Beanery's Franchise Agreement ("franchise agreement"). On June 17, 2003, Welshans and Williams visited the Coffee Beanery's corporate headquarters in Flushing, Michigan. Respondents contend that, during this visit, Kevin Shaw made false representations and/or failed to disclose material information concerning the earnings potential of Coffee Beanery Café franchises. On that date, Welshans executed a franchise agreement, pursuant to which he agreed to purchase and operate a Coffee Beanery Café franchise. On August

21, 2003, Welshans assigned the franchise agreement to WW.

The franchise agreement contains a dispute resolution clause that requires the parties to engage in non-binding mediation in Flushing, Michigan, to resolve "any claim or controversy arising out of or related to [the franchise agreement], or the making, performance, breach, interpretation, or termination thereof." (Am. Petition, Ex. 2 § 23.2.) The franchise agreement further provides that no arbitration or litigation may be commenced on any claim subject to mediation prior to the "mediation termination date" – which the franchise agreement defines as within sixty days of the issuance of a request for mediation or such longer period as may be agreed upon by the parties in writing. (*Id.* §§ 23.3 & 23.3.3.) The franchise agreement also requires the parties to engage in arbitration to resolve "any claim or controversy arising out of or related to this Agreement, or the making, performance, breach, interpretation, or termination thereof . . . " (*Id.* § 23.4.)

On January 21, 2005, WW, through its attorney, sent the American Arbitration Association ("AAA") and the Coffee Beanery a "Demand for Mediation and Arbitration." (Am.Petition, Ex. 7.) The Demand stated the nature of the dispute to be mediated and arbitrated as follows:

> Declaratory Judgment, Fraud, Negligent Misrepresentation, Fraudulent Misrepresentation, Fraudulent Nondisclosure, Negligent

> Nondisclosure, Breach of Contract, Breach of Covenant of Good Faith and Fair Dealing, violations of the Maryland Franchise Registration and Disclosure Law . . . Michigan's Consumer Protection Act . . .

(*Id.*) On January 31, 2005, AAA sent correspondence to the Coffee Beanery and WW offering mediation and noting that the franchise agreement stipulates to the location of mediation as Flushing, Michigan. Although mediation subsequently was scheduled, no mediation ever occurred. As indicated previously, the matter instead proceeded to arbitration in January 2007.

In the meantime, on January 19, 2006, the Maryland Securities Commissioner ("Commissioner") brought an administrative action against the Coffee Beanery and Kevin Shaw by way of an order to show cause. The Commissioner issued an amended order to show cause on February 3, 2006. According to the Commissioner's show cause orders, the Securities Division of the Office of the Attorney General of Maryland initiated an investigation into the franchise-related activities of the Coffee Beanery and Kevin Shaw with respect to respondents, and found grounds to allege violations of the disclosure and antifraud provisions of Maryland Franchise Law. The orders further require the Coffee Beanery and Kevin Shaw to show cause why they should not be ordered to permanently cease and desist from the offer and sale of franchises in violation of the Maryland Franchise Law. The orders require the Coffee

Beanery and Kevin Shaw to file a written answer within fifteen days, responding to the allegations in the orders and indicating whether they request a hearing.

On September 12, 2006, the Coffee Beanery and Kevin Shaw entered into a Consent Order with the Commissioner. (Resp.' Mot. Vacate, Ex. 1.) In the "Statement of Facts" section, the Consent Order details *inter alia* supposed deficiencies in the UFOC Welshans received from the Coffee Beanery in June 2003. Specifically, the Consent Order provides that the UFOC failed to disclose when the Coffee Beanery began selling franchises for Café Stores and provided figures for Coffee Beanery franchises (e.g., number of outlets opened, in operation, and closed and contact information for current and terminated franchises) without differentiating between Café and non-Café franchises. The Consent Order contains the following conclusions of law:

> 30. Respondent Coffee Beanery violated section 14-229 of the Maryland Franchise Law by making material misrepresentations of fact or omissions of material fact about the Coffee Beanery franchise offering to prospective Maryland franchisees.
>
> 31. Respondent Coffee Beanery violated section 14-223 of the Maryland Franchise Law by offering and selling franchises in Maryland without giving franchisees a copy of the form of offering prospectus required under the Maryland Franchise Law.

(*Id.*) However the Consent Order further provides that, by entering the Consent Order, the Coffee Beanery and Kevin Shaw do not admit or deny the statement of facts or conclusions of law contained therein. (*Id.*) The Consent Order also states that the Coffee Beanery and Kevin Shaw "may deny any statement of fact or conclusion of law of the Consent Order in any proceeding, litigation, or arbitration against them in which the Commissioner is not a party; . . . " (*Id.*)

As relevant to the pending motions, the Consent Order imposes the following sanctions on the Coffee Beanery and Kevin Shaw:

> A. Respondents will permanently cease and desist from offering and selling franchises in Maryland or to any prospective Maryland franchisees in violation of the Maryland Franchise Law.
>
> B. Coffee Beanery agrees to make a rescission offer to the Welshans [sic], by and through WW, LLC, and any other Maryland residents who purchased a Coffee Beanery Café Store franchise after January 1, 2003, by sending those franchisees: (i) a copy of this Consent Order; and (ii) a letter, in substantially the form attached to this letter as Exhibit 1, notifying those franchisees that they have the right to rescind their Coffee Beanery franchise agreements.

(*Id.*) The letter attached as Exhibit 1 to the Consent Order, which is entitled "Notice of Offer to Rescind

Franchise Agreement," grants a franchisee thirty (30) days from the date of the franchisee's receipt of the letter to rescind its franchise agreement with the Coffee Beanery. (*Id.*) It appears that, although seeking rescission in the arbitration proceedings, respondents never accepted the offer to rescind required by the Consent Order.[1]

II. Applicable Standard of Review

The Federal Arbitration Act provides that, where the parties have agreed that a judgment of the court shall be entered upon an arbitration award, any party, within one year after such an award, "may apply to the court so specified for an order confirming the award, and thereupon the court *must* grant such an order unless the award is vacated, modified, or corrected as prescribed in [9 U.S.C. §§ 10 & 11]."[2] 9 U.S.C. § 9 (emphasis added).

9 U.S.C. § 10 provides the following grounds for a federal court to vacate an arbitration award:

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[1] In her award, the arbitrator concluded that respondents "are barred from electing rescission under the Consent Order because they did not accept the rescission offer within the stated 30-day period." (Pet.'s Mot. to Confirm, Ex. A.) Although disputing several findings of the arbitrator, respondents do not contest the accuracy of this finding.

[2] In their motion to vacate the arbitration award, respondents rely on Section 10 of the Act, only.

> (1) where the award was procured by corruption, fraud, or undue means;
>
> (2) where there was evident partiality or corruption in the arbitrators, or either of them.
>
> (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any misbehavior by which the rights of the party have been prejudiced; or
>
> (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter was not made.

9 U.S.C. § 10(a) (2002). A federal court's power to vacate an arbitration award "is almost exclusively confined to the four grounds specified in the Federal Arbitration Act, 9 U.S.C. § 10." *NCR Corp. v. Sac-Co., Inc.*, 43 F.3d 1076, 1079 (6th Cir.1995) (citations omitted). However, a court also may vacate an award if the conduct of the arbitrator(s) constitutes "manifest disregard" of the applicable law. *Id.* (citations and quotation marks omitted).

Nevertheless, a court's review of an arbitration award "is generally extremely narrow." *Id.* The Supreme Court has long held that "the courts play only a limited role when asked to review the decision of an arbitrator. The courts are not authorized to reconsider the merits of an award even though the parties

may allege that the award rests on errors of fact or on misinterpretation of the contract." *United Paperworkers Int'l Union v. Misco, Inc.*, 484 U.S. 29, 36, 108 S.Ct. 364, 370, 98 L.Ed.2d 286 (1987). As the Supreme Court has stated differently, even "the arbitrator's 'improvident, even silly, factfinding' does not provide a basis for a reviewing court to refuse to enforce the award." *Major League Baseball Players Ass'n v. Garvey*, 532 U.S. 504, 509, 121 S.Ct. 1724, 1728, 149 L.Ed.2d 740 (2001) (quoting *Misco*, 484 U.S. at 39, 108 S.Ct. 364, 98 L.Ed.2d 286). Extending this standard of review beyond the labor relations context, the Sixth Circuit Court of Appeals has stated: "Courts must refrain from reversing an arbitrator simply because the court disagrees with the result or believes the arbitrator made a serious legal or factual error." *Solvay Pharm., Inc. v. Duramed Pharm., Inc.*, 442 F.3d 471, 476 (2006) (emphasis removed). "And 'if a court can find any line of argument that is legally plausible and supports the award then it must be confirmed.'" *Id.* (quoting *Merrill Lynch, Pierce, Fenner & Smith v. Jaros*, 70 F.3d 418, 421 (6th Cir.1995)).

III. Analysis

The parties' franchise agreement provides that any arbitration award "shall be binding" on the parties and "may be entered and enforced in any court of competent jurisdiction." (Am. Pet., Ex. 2 ¶ 23.4.) Thus, this Court must confirm the arbitrator's award, unless the Court concludes that the

award should be vacated pursuant to Section 10 of the Act.

In their motion to vacate the arbitration award and in their response to petitioners' motion to confirm the award, respondents assert numerous arguments as to why they believe the arbitration award must be vacated. While both pleadings do not set forth all of the same arguments, in response to petitioners' motion to confirm the arbitration award, respondents categorize their arguments as follows:[3] (i) issues in the creation of the arbitration agreement; (ii) problems with the [arbitration] process as implemented by the [Coffee Beanery] and the AAA; (iii) perjury of the Coffee Beanery at the arbitration; and, (iv) the arbitrator showed a manifest disregard of the law. Under this latter heading, and throughout their motion to vacate the arbitration award, respondents argue that the arbitrator disregarded the law and ignored the facts that favored their version of the relevant events. Thus the Court will address these different alleged grounds for vacating the award separately.

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[3] In their motion to vacate the arbitration award, respondents do not categorize their arguments in support of the motion according to the above-identified categories. Nevertheless, their arguments fall under these headings.

A. Issues in the Creation of the Arbitration Agreement

Respondents contend that they were "led to believe . . . that they would be able to litigate their Maryland Franchise Registration and Disclosure Law claims, and consequently, all other pendent claims, in Maryland courts." (Resp.'s Br. in Supp. of Mot. to Vacate at 7.) Respondents further argue that "[n]owhere was it disclosed to them that they would have to arbitrate their Maryland statutory claims in Michigan at great expense and . . . that the AAA is biased or that the costs of a AAA arbitration . . . are exceedingly high and unduly burdensome." (*Id.*) Respondents then proceed to set forth fourteen aspects of AAA's arbitration process they believe "mandate that the arbitration be vacated." (*Id.* at 10.)

As an initial matter, respondents' arguments are relevant to a determination of whether the arbitration provision in the franchise agreement is enforceable. Respondents failed to raise these arguments earlier in this litigation when petitioners moved to compel arbitration. In any event, this Court finds that the language of the franchise agreement clearly disclosed to respondents not only that their claims were subject to arbitration, but that the AAA would conduct any arbitration and would do so according to its rules and procedures. *See, supra.*

To the extent there is any merit to respondents' claim that the AAA is biased to corporations, such a broad indictment of the association fails to demonstrate

"evident partiality" under Section 10 of the Federal Arbitration Act. Interpreting this ground, courts have explained: "The alleged partiality must be direct, definite, and capable of demonstration, and 'the party asserting it . . . must establish specific facts that indicate improper motives on the part of the arbitrator.'" *Andersons, Inc. v. Horton Farms, Inc.*, 166 F.3d 308, 329 (6th Cir.1998) (quoting *Consolidation Coal Co. v. Local 1643, United Mine Workers of Am.*, 48 F.3d 125, 129 (4th Cir.1995)). " . . [T]he party seeking invalidation must demonstrate more than amorphous institutional predisposition toward the other side; a lesser showing would be tantamount to an 'appearance of bias' standard." *Nationwide Mut. Ins. Co. v. Home Ins. Co.*, 429 F.3d 640, 645 (6th Cir.2005) (citing *Andersons*, 166 F.3d at 329).

B. Problems with the Arbitration Process

Respondents argue that the franchise agreement required the parties to mediate any disputes within 60 days of a demand for mediation, but mediation did not occur within that time period and, in fact, did not occur at all. Respondents contend that misconduct by petitioners and AAA precluded mediation and compelled arbitration, contrary to respondents' mediation demand. Respondents further argue that the arbitration process was flawed as a result of Joanne Barron's appointment as the arbitrator, as Barron and the Coffee Beanery use the same accounting firm.

For the same reasons discussed above regarding respondents' claim that the AAA is a partial body, the mere fact that Ms. Barron and the Coffee Beanery are associated with the same accounting firm does not establish a ground under Section 10 for vacating Ms. Barron's arbitration award. To the extent respondents argue that Ms. Barron ignored facts or law due to her impartiality, the Court will address those arguments below.

Contrary to respondents' interpretation of the franchise agreement, the parties do not have to engage in mediation before arbitration may proceed. Rather, Section 23.3 of the franchise agreement states that "[n]o arbitration or litigation may be commenced on any claim which is subject to mediation . . . *prior to the mediation termination date,* as defined in Section 23.3.3, *whether or not the mediation has been commenced.*" (Am. Pet., Ex. 2 ¶ 23.3.) Section 23.3.3 provides that "[n]on-binding mediation . . . shall be concluded within sixty (60) days of the issuance of the request [for mediation], or such longer period as may be agreed upon by the parties in writing ("mediation termination date")." (*Id.* ¶ 23.3.3.) In this case, respondents filed a demand for mediation, along with a demand for arbitration, on January 21, 2005. There is no evidence that the parties agreed in writing to a longer mediation termination date. Therefore, arbitration properly commenced in this case in January 2007 – obviously well beyond the sixty day mediation termination date.

C. Perjury of the Coffee Beanery at the Arbitration

Respondents claim that Joanne Shaw committed perjury during the arbitration. Respondents identify two instances of supposed perjury in support of this allegation: (1) Joanne Shaw's testimony that the Coffee Beanery always listed the home addresses for terminated franchisees; and (2) her testimony that the Coffee Beanery made the changes required by the Maryland Securities Commissioner and in all other states with registration requirements. As to the first instance, respondents fail to point the Court to the relevant portion of the arbitration transcript where this alleged perjury occurred. Thus the Court is not able to evaluate whether, in fact, Joanne Shaw's testimony was false. In any event, even if her statements were false, respondents cannot satisfy the three part test used to evaluate whether an arbitration award should be vacated for fraud.

To merit the vacation of an arbitration award for fraud, the movant must establish "(1) clear and convincing evidence of fraud, (2) that the fraud materially relates to an issue involved in the arbitration, and (3) that due diligence would not have prompted the discovery of the fraud during or prior to the arbitration." *Inter'l Bhd. of Teamsters, Local 519 v. U.P.S.*, 335 F.3d 497, 503 (6th Cir.2003) (citation omitted); *see also Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378, 1383 (11th Cir.1988) (formulating test). Even assuming that respondents are able to prove the first two elements, there can be no doubt

that respondents were aware of or could have discovered the alleged falsity of Joanne Shaw's testimony during the arbitration. Respondents obtained or could have obtained copies of the Coffee Beanery's updated UFOCs prior to the arbitration. Because respondents therefore had the opportunity to cross-examine Joanne Shaw with regard to the alleged perjury, the Court concludes that fraud is not a basis for vacating the arbitration award. *See O.R. Sec., Inc. v. Prof'l Planning Assoc.*, 857 F.2d 742, 749 (11th Cir.1988) (denying motion to vacate arbitration award on the grounds of fraud because the moving party had the opportunity to cross-examine on the alleged false testimony).

D. The Arbitrator's Disregard of the Law

Respondents assert several arguments in their opposition to petitioners' motion to confirm the arbitration award under the heading: "The Arbitrator Showed Manifest Disregard of the Law." (Resp.'s Br. in Resp. to Mot. to Confirm at 18.) In this section, however, respondents fail to cite specific law that they believe the arbitrator disregarded. Instead, respondents simply identify numerous areas where they believe the arbitrator disregarded evidence that favored their version of the events leading to Welshans' execution of the franchise agreement. However, in their motion to vacate the arbitration award, respondents identify several points of law that they claim the arbitrator disregarded.

Respondents first claim that, under Maryland Franchise Registration and Disclosure Law, they had the power to rescind the franchise agreement within three years of their receipt of the UFOC, if the Coffee Beanery failed to disclose certain information before Welshans executed the franchise agreement. (Resp.'s Br. in Supp. of Mot. to Vacate at 17.) Respondents, however, do not cite the relevant law for the Court. In any event, pursuant to the Consent Order – which was premised on the violation of Maryland franchise law – the Maryland Securities Commissioner required the Coffee Beanery and Kevin Shaw to offer respondents the opportunity to rescind the franchise agreement by sending them a letter "in substantially the form attached to [the Consent Order] as Exhibit 1. . . ." According to that letter, a franchisee had to respond within thirty (30) days in order to invoke its right to rescind. Respondents apparently failed to accept the offer within the allotted time period.

Respondents next assert that the arbitrator added a reliance element and intent element into Maryland franchise law. This is not necessarily true. The arbitrator did find that "there was no intent on the part of [The Coffee Beanery and Kevin Shaw] to mislead Claimants [WW, Ms. Williams or Mr. Welshans] or misrepresent the franchise system." (Pet.'s Mot. to Confirm Award, Ex. A at 2.) The arbitrator also concluded that "Claimants did not rely on any sales or expense information provided by [The Coffee Beanery and Kevin Shaw]." (*Id.* at 3.) Neither

of these findings, however, were made specifically with regard to respondents' claim that petitioners violated Maryland franchise law, as opposed to respondents' claims of fraud, fraudulent inducement, misrepresentation, negligent misrepresentation or detrimental reliance. Most, if not all, of these claims require a showing of intent and/or reliance.

Respondents also contend that the arbitrator disregarded the Maryland Securities Commissioner's legal conclusions – an argument the Court only needs to focus on briefly. As set forth previously, the Consent Order expressly provides that the factual findings and legal conclusions therein are not binding upon the Coffee Beanery and Kevin Shaw "in any proceeding, litigation, or arbitration against them in which the Commissioner is not a party."

Respondents further claim that the arbitrator made a "ludicrous determination" by finding that none of the respondents had standing. (Resp.'s Br. in Supp. of Mot. to Vacate at 19.) The Court is not convinced that the arbitrator made such a finding. In any event, respondents fail to demonstrate that such a finding is an error of law, much less a "manifest disregard" of the law. *See supra.* To make this showing, respondents had to show that the relevant law is clearly defined and that the arbitrator consciously chose not to apply it. *Dawahare v. Spencer,* 210 F.3d 666, 669 (6th Cir.2000) (rejecting party's assertion that the arbitrator disregarded the law and noting that since 1953, when the Supreme Court established the manifest disregard of the law standard as a basis

for vacating an arbitration award, only two federal courts of appeals have used it to vacate arbitration decisions.)

E. The Arbitrator's Disregard of the Facts

Finally, respondents assert that the arbitrator disregarded facts establishing their claims against petitioners. First respondents fault the arbitrator for disregarding the factual findings set forth in the Consent Order. Those factual findings, however, were not binding on petitioners or the arbitrator in the arbitration proceeding. *See supra.* Respondents further argue, however, that the arbitrator's alleged wholesale rejection of its witnesses and evidence demonstrate her bias in favor of petitioners.

As an initial matter, while the Sixth Circuit has adopted "manifest disregard of the law" as a ground for vacating an arbitration award, it is not evident that the court has also adopted the ground of "manifest disregard of the facts." The Federal Arbitration Act does not grant courts the authority to review arbitrators' decision *de novo.* As this Court emphasized in a previous case: "Arbitration does not provide a system of 'junior varsity trial courts' affording the losing party complete and rigorous *de novo* review." *Terk Technologies Corp. v. Dockery,* 86 F.Supp.2d 706, 708 (E.D.Mich.2000) (quoting *Nat'l Wrecking Co. v. Int'l Bhd. of Teamsters, Local 731,* 990 F.2d 957, 960 (7th Cir.1993)). Such a standard of review is contrary to the Act's purpose: " . . . to relieve

congestion in the courts and to provide parties with an alternative method for dispute resolution that would be speedier and less costly than litigation." *O.R. Sec., Inc. v. Prof'l Planning Assoc., Inc.*, 857 F.2d 742, 745-46 (11th Cir.1988) (*Ultracashmere House, Ltd. v. Meyer*, 664 F.2d 1176, 1179 (11th Cir.1981)).

Respondents do not contend that they asked for, but were denied, a delay in the arbitration hearing; nor do respondents claim that they were prevented from presenting evidence to the arbitrator. *See* 9 U.S.C. § 10(a)(3). Respondents only assert that the arbitrator failed to accept their version of the evidence and wrongly found petitioners' witnesses more credible. Absent specific facts indicating that the arbitrator had an improper motive for ruling in favor of petitioners, respondents' belief that the arbitrator should have adopted their version of the relevant events does not warrant this Court's complete review of the evidence presented in the arbitration proceedings. " . . . [I]t is the arbitrator's role to make factual findings, weigh evidence, and assess the credibility of witnesses, and it is well-settled that 'a federal court may not conduct a reassessment of the evidentiary record.'" *Nicholls v. Brookdale Univ. Hosp. and Med. Center*, 204 Fed.Appx. 40, 43 (2d Cir.2006) (quoting *Wallace v. Buttar*, 378 F.3d 182, 193 (2d Cir.2004)).

IV. Conclusion

Based on the above, the Court concludes that respondents fail to state a ground for vacating the arbitration award under Section 10 of the Federal Arbitration Act. Thus, pursuant to Section 9 of the Act, this Court must confirm the award.

Accordingly,

IT IS ORDERED, that Respondents' Motion to Vacate Arbitration Award is **DENIED**;

IT IS FURTHER ORDERED, that Petitioners' Application/Motion to Confirm Arbitration Award is **GRANTED**;

IT IS FURTHER ORDERED, that the arbitrator's March 28, 2007 award is **CONFIRMED** and may be enforced according to its terms.

AMERICAN ARBITRATION ASSOCIATION
Commercial Arbitration Tribunal

In the Matter of the Arbitration between

Re: 54 11 00124 05

WW, LLC, t/a The Coffee Beanery Café
Deborah Williams
Richard Welshans — Claimants

And

The Coffee Beanery, LTD
JoAnne Shaw
Julius L. Shaw
Kevin Shaw
Kurt Shaw
Ken Coxen
Walter Pilon
Owen Stern — Respondents

AWARD OF ARBITRATOR

I, JoAnne Barron, THE UNDERSIGNED ARBITRATOR, having been designated in accordance with the arbitration agreement entered into between the above-named Parties and dated June 17, 2003, and having been duly sworn, and having duly heard the proofs and allegations of the Parties, does hereby, AWARD, as follows:

Claimants are the original franchisee (Welshans), the current franchisee (WW, LLC), and the member/owners of the current franchisee (Welshans and

Williams). Respondents are the franchisor (Coffee Beanery, LTD) and its officers and employees (JoAnne Shaw, Julius L. Shaw, Kevin Shaw, Kurt Shaw, Ken Coxen, Walter Pilon and Owen Stern). All claims and counterclaims submitted by the Parties are subject to arbitration pursuant to the franchise agreement and were considered and resolved by the Arbitrator.

Based on the credible evidence as a whole, Claimants did not prove their claims of common law fraud by clear and convincing evidence, and did not prove their claims of fraudulent inducement and misrepresentation, negligent misrepresentation, detrimental reliance, and violations of the Michigan and Maryland franchise investment laws, by a preponderance of the evidence.

The individual Respondents, having successfully defended all claims brought by Claimants, are prevailing parties. Respondent, Coffee Beanery, LTD having successfully defended all claims brought by Claimants, and having proved its counterclaim for past due royalties, reasonable attorney and accounting fees and costs and expenses pursuant to the terms of the franchise agreement, is a prevailing party.

Reasons for the Award:

The franchise agreement dated June 17, 2003, the guaranty agreement, and the assignment of the franchise to WW, LLC on August 31, 2003 are valid, effective, and enforceable agreements that are binding on the Parties.

The Arbitrator finds that there was no intent on the part of Respondents to mislead Claimants or misrepresent the franchise system. The credible evidence showed that Respondents provided Claimants with, adequate, proper and timely disclosure (UFOC and related documents) under Michigan and Maryland franchise laws, excellent training, competent assistance with store location, competent lay-out of the store and business start-up resources, comprehensive operations, training and equipment manuals, excellent coffee and related products, available trouble-shooting resources, and available financial assistance. Although Claimants experienced a few significant problems with equipment, furniture and fixtures, Respondents attempted to render assistance to help Claimants resolve the problems, and the problems did not cause damage to Claimants' business. The credible evidence showed that factors outside of the franchise system including the economy of the local marketplace, demographics, competition, and operator inexperience were the likely causes of the lack of success of Claimants' business.

Claimant Williams did not sign the franchise agreement, did not purchase the franchise and was not granted a franchise. Claimant is a member/owner of WW, LLC but made no monetary investment in the franchise. Claimant did not prove that she sustained damages or is entitled to rescission or any other statutory, common law or equitable relief.

Claimant WW, LLC did not sign the franchise agreement, did not purchase a franchise and was not

granted a franchise. Claimant obtained the rights and interest in the franchise by assignment. Claimant did not prove that it sustained damages or is entitled to rescission or any other statutory, common law or equitable relief. The Arbitrator found the testimony of witnesses Welshans, Williams and their expert witness Lombardo with regard to the claim for damages, not credible.

Claimant Richard A. Welshans signed the franchise agreement, purchased the franchise and was granted a franchise. Claimant Welshans is the guarantor of the obligations of the franchisee WW, LLC under the franchise agreement. Claimant Welshans did not prove that he sustained damages individually or as a member/owner of WW, LLC or is entitled to rescission or any other statutory, common law or equitable relief. The Arbitrator found the testimony of witnesses Welshans, Williams and their expert witness Lombardo with regard to the claim for damages, not credible.

Claimants are not entitled to rescission of the franchise agreement and did not prove damages based on alleged violations of Maryland and Michigan franchise investment laws. The Arbitrator found Claimant Welshans' version of the events surrounding receipt of the UFOC not credible. Respondents sent Claimant Welshans the UFOC via Federal Express on May 30, 2003. Claimant Welshans received the UFOC on June 2, 2003 and did not sign the franchise agreement until June 17, 2003. Based on

the credible evidence, the Arbitrator finds that Respondents timely complied with disclosure requirements.

Claimants are not entitled to rescission of the franchise agreement and did not prove damages based on the alleged failure to disclose more or different information about Café stores. The Arbitrator is not bound by the apparent conclusions of the Maryland Commissioner or the statements, conclusions or opinions set forth in the Consent Order because the Commissioner was not and is not a Party to the arbitration proceeding, and the Consent Order, by its terms, does not contain admissions of the Parties. Based on the credible testimony of Respondents' witnesses and documentary evidence, the Arbitrator finds, contrary to the statements, conclusions and opinions of the Maryland Commissioner, that Respondents complied with Maryland (and Michigan) franchise laws regarding disclosure of information related to Café stores.

Claimants WW, LLC and Welshans are not entitled to rescission of the franchise agreement and did not prove damages based on non-disclosure of the Gift Card, DMX and Pepsi contracts. The Arbitrator finds that the Gift Card program and the DMX system were not required programs and that Claimants' participation was voluntary. Claimants did not elect to participate in the Gift Card program. Claimants purchased the DMX system as part of the equipment package and elected to sign the contract and participate in the music program for a monthly

fee. The DMX system provided a significant benefit to Claimants' franchise. Although the evidence showed that Pepsi products were required and approved products, Claimants failed to prove by a preponderance of the evidence that a Pepsi contract, subject to disclosure laws, was actually in effect in 2002-2003 when Claimant purchased the franchise. The Arbitrator finds that Claimants failed to show damages caused by or linked to non-disclosure of the three contracts.

Claimants failed to timely and effectively tender back the benefits of the franchise (trademarks, equipment, location, etc.) to Respondents. The Arbitrator finds that, contrary to Claimants' stated intent to rescind the franchise agreement, Claimants continued to operate the business utilizing the Coffee Beanery trademarks, products and franchise system. Claimants are not entitled to rescission and are barred from electing rescission under the Consent Order because they did not accept the rescission offer within the stated 30-day period.

The Arbitrator finds, based on the credible evidence, that Respondent Kevin Shaw did not make earnings claims verbally or in writing to Claimants prior to the purchase of the franchise to induce Claimants to purchase the franchise. Claimants did not rely on any sales or expense information provided by Respondents. Claimants were convinced that they had the skills, experience and talent to run a successful business and were determined to purchase a Coffee Beanery franchise, secure the location with

an executed lease, and open the business, as quickly as possible.

The Arbitrator finds that Respondent was not required to disclose to Claimants that Kevin Shaw has a felony conviction for grand larceny as it is not the, type of felony conviction subject to disclosure. Michigan and Maryland franchise laws limit such disclosure to felonies that involve fraud, embezzlement, fraudulent conversion, or misappropriation of property. Furthermore, the non-disclosure did not cause damage to Claimants.

Claimant Williams is not liable for any damages sustained by Respondent.

Claimant Welshans is individually liable for damages sustained by Respondent under the franchise agreement based on the guaranty agreement.

Claimant WW, LLC is liable for damages sustained by Respondents under the franchise agreement based on assignment of the rights, interest and liabilities under the franchise agreement.

Claimants WW, LLC and Richard A. Welshans are jointly and severally liable to pay Respondents past due royalties in the amount of $13,710.16.

In addition, Respondents, as prevai' ng Parties are entitled to reasonable attorney and accounting fees in the amount of $105,932.40 (determined by the Arbitrator to be 50% of the requested amount of such fees) plus all expenses claimed by Respondents in the amounts as follows:

Airfare, vehicle rental, motel charges, meals, witness Bechard expenses:	$	1,963.11
Witness Greenbaum expenses:	$	737.03
Mileage expenses:	$	926.00
Meal expenses:	$	504.25
Room and related expenses:	$	2,808.16
Court Reporter expenses	$	17,785.62
Total amount of past due royalties, reasonable attorney/accounting fees, costs and expenses:	$	144,366.73

The administrative fees of the American Arbitration Association totaling $8,500.00, and the compensation of the Arbitrator totaling $16,800.00 shall be borne by Claimants, WW, LLC and Richard A. Welshans, jointly and severally.

Therefore, Claimants, WW, LLC and Richard A. Welshans shall reimburse Respondents the sum of $8,400.00 representing that portion of said fees and expenses in excess of the apportioned costs previously incurred and paid by Respondents.

This Award is in full settlement of all claims and counterclaims submitted to this Arbitration. All claims not expressly granted herein are hereby, denied.

Date: 3/28/2007 /s/ JB
JoAnne Barron

I, JoAnne Barron, do hereby affirm upon my oath as Arbitrator that I am the individual described in and who executed this instrument which is my Award.

Date: 3/28/2007 /s/ JoAnne Barron
JoAnne Barron

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

THE COFFEE BEANERY LTD, JOANNE SHAW, JULIUS SHAW, KEVIN SHAW, KURT SHAW, KEN COXEN, WALTER PILON, and OWEN STEARN,

Petitioners,

v.

WW L.L.C, DEBORAH WILLIAMS, and RICHARD WELSHANS,

Respondents.
_____/

Case No. 06-10408
Honorable
Patrick J. Duggan

OPINION AND ORDER DENYING RESPONDENTS' MOTION FOR RECONSIDERATION

At a session of said Court, held in the U.S. District Courthouse, Eastern District of Michigan, on August 16, 2007.

PRESENT: THE HONORABLE
PATRICK J. DUGGAN
U.S. DISTRICT COURT JUDGE

Petitioners initiated this action to compel arbitration to resolve a dispute between themselves and respondents arising from a franchise agreement pursuant to which respondents purchased and operated a Coffee Beanery Café. Following the court-compelled arbitration proceeding, petitioners filed a motion to

confirm the arbitration award and respondents filed a motion to vacate the award. On May 23, 2007, this Court issued an opinion and order granting petitioners' motion and denying respondents' motion. On June 4, 2007, respondents filed a motion for reconsideration. This Court subsequently issued a notice, informing the parties that petitioners may file a response to the motion for reconsideration, if they chose to do so. Petitioners filed a response on June 13, 2007; respondents filed a reply on June 15, 2007. After careful review, the Court denies respondents' motion.

Standard of Review

A motion for reconsideration will be granted only if the moving party demonstrates "a palpable defect by which the court and the parties have been misled" and that "correcting the defect will result in a different disposition of the case." E.D. Mich. LR 7.1(g)(3). A motion that merely presents the same issues already ruled upon by the Court, either expressly or by reasonable implication, shall not be granted. E.D. Mich. LR 7.1(g). On the other hand, a court need not consider issues raised for the first time in a motion for reconsideration that could and should have been raised previously, as such motions are "aimed at reconsideration, not initial consideration." *Wardle v. Lexington-Fayette Urban County Gov't,* 45 Fed. App'x 505, 511 (6th Cir. 2002) (internal quotation marks and citations omitted). Similarly, motions for reconsideration "cannot . . . be employed as a vehicle to

introduce new evidence that could have been adduced during the pendency [of the motion on which the court ruled]." *Marketing Displays, Inc. v. TrafFix Devices, Inc.*, 971 F. Supp. 262, 281 (ED. Mich. 1997) (citing *Publishers Res., Inc. v. Walker-Davis Publ'ns, Inc.*, 762 F.2d 557, 561 (7th Cir. 1985) (emphasis in original removed)).

Issues Presented and Analysis

To support their motion for reconsideration, respondents identify two alleged defects in the Court's May 23, 2007 decision. First, respondents claim that the Court erred in concluding that their failure to accept the rescission offer in the Maryland administrative proceeding barred their right to seek rescission. To demonstrate that this failure did not preclude their claim for rescission under Maryland Franchise Law, respondents offer a January 2, 2007 letter the Maryland Securities Commissioner ("Commissioner") sent to their counsel. In her letter, the Commissioner states, in part:

> If your clients determined that the form of rescission offer described in the Consent Order was not appropriate to resolve their dispute with Coffee Beanery, they were not obligated to accept that offer. The resolution of this proceeding by the Securities Commissioner does not limit your clients' right to pursue a private cause of action under the Maryland Franchise Law.

(Mot. for Recons. Ex. 1.)

Even if respondents' claim of error is accurate, correcting this error does not result in a different disposition of the case. The arbitrator actually found that respondents were barred from seeking rescission because they did not accept the rescission offer in the Consent Order within thirty days *and* they continued to operate the business utilizing the Coffee Beanery trademarks, products, and franchise system – conduct which was contrary to their stated intent to rescind the franchise agreement. (Doc. 22 Ex. A [Arbitration Award] at 3.) Respondents did not challenge this conclusion in their motion to vacate the arbitration award or in their opposition to petitioners' motion to confirm the award.

Instead, in their motion to vacate the arbitration award, respondents only asserted that, under Maryland Franchise Law, they had the right to seek rescission within three years of receipt of the UFOC as a result of petitioners' failure to disclose required information.[1] (Doc. 21 at 17.) In any event, the arbitrator's conclusion was not the only basis for her decision that respondents were not entitled to rescission. The arbitrator also relied on her finding that petitioners timely complied with the disclosure requirements under Michigan's and Maryland's franchise laws. (*Id.* at 2-3.)

---

[1] The Court also notes that respondents did not attach the Commissioner's January 2, 2007 letter to their earlier pleadings, although the letter was available before the Court issued its decision to confirm the arbitration award.

Respondents' second claim of error relates to the arbitrator's rejection of the Commissioner's conclusion that petitioners violated Maryland Franchise Law. Respondents argue that the evidence presented during the arbitration hearing established - contrary to the arbitrator's findings and consistent with the factual conclusions in the Consent Order – that petitioners failed to disclose material information before respondents executed the franchise agreement. Respondents specifically focus on petitioners' alleged failure to disclose the "Gift Card Program," a Pepsi contract, and respondent Kevin Shaw's prior grand larceny conviction.

With respect to Kevin Shaw's prior conviction, the arbitrator concluded that this conviction was not the type of felony conviction subject to disclosure under the franchise laws of Maryland and Michigan. (Doc. 22 Ex. A at 3.) The arbitrator also concluded that the non-disclosure did not cause damage to respondents. (*Id.*) Respondents never argued to this Court, prior to their motion for reconsideration, that the arbitrator's analysis of this conviction was wrong. The Court will not consider respondents' belated argument now as a basis for vacating the arbitration award.

With respect to respondents' dispute with the arbitrator's other factual determinations, respondents raised the same argument in their motion to vacate the award and in response to petitioners' motion to confirm the award. The Court already rejected this "manifest disregard of the facts" argument, concluding

that it is not a ground for vacating the arbitrator's award absent evidence that the arbitrator had an improper motive for accepting petitioners' version of the relevant events. (5/23/07 Op. and Order at 17.) As this Court concluded in its May 23, 2007 opinion and order, " . . . [I]t is the arbitrator's role to make factual findings, weigh evidence, and assess the credibility of witnesses, and it is well-established that 'a federal court may not conduct a reassessment of the evidentiary record.'" *Nichols v. Brookdale Univ. Hosp. and Med. Center*, 204 Fed. App'x 40, 43 (2d Cir. 2006) (quoting *Wallace v. Buttar*, 378 F.3d 182, 193 (2d Cir. 2004)).

For the above reasons, the Court does not find a palpable defect in its prior decision that, if corrected, will result in a different disposition of the case.

Accordingly,

IT IS ORDERED, that respondents' motion for reconsideration is **DENIED**.

s/PATRICK J. DUGGAN
UNITED STATES
DISTRICT JUDGE

Copies to:
Karl V. Fink, Esq.
Harry M. Rifkin, Esq.
Mark J. Kriger, Esq.

No. 07-1830

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

COFFEE BEANERY, LTD., ET AL.,	)	
Petitioners-Appellees,	)	ORDER
v.	)	(Filed Feb. 9, 2009)
WW, L.L.C., ET AL.,	)	
Respondents-Appellants.	)	

BEFORE: COLE and CLAY, Circuit Judges; and RUSSELL,* District Judge.

The court having received a petition for rehearing en banc, and the petition having been circulated not only to the original panel members but also to all other active judges of this court, and no judge of this court having requested a vote on the suggestion for rehearing en banc, the petition for rehearing has been referred to the original panel.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

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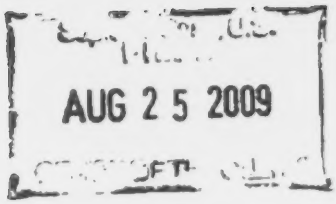
* Hon. Thomas B. Russell, United States District Judge for the Western District of Kentucky, sitting by designation.

ENTERED BY ORDER OF THE COURT

/s/ Leonard Green
Leonard Green
Clerk

(3)



No. 08-1396

IN THE

Supreme Court of the United States

THE COFFEE BEANERY, LTD., ET AL.,

Petitioners,

v.

WW, LLC, RICHARD WELSHANS, AND DEBORAH WILLIAMS,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

RESPONDENTS' BRIEF IN OPPOSITION

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August 2009

QUESTION PRESENTED

1. Under the Federal Arbitration Act, courts may vacate arbitration awards when arbitrators have "exceeded their powers." 9 U.S.C. § 10(a)(4). Every circuit to squarely address the issue has held that arbitrators may exceed their powers under Section 10(a)(4) by manifestly disregarding the law, and no circuit has foreclosed that manifest-disregard standard. In the absence of a circuit split, should this Court grant certiorari to decide whether the manifest-disregard standard is consistent with Section 10(a)(4)?

2. Should the Court grant certiorari to decide whether, assuming the manifest-disregard standard is consistent with Section 10(a)(4), the decision below misapplied that standard to the facts of this case?

DISCLOSURE STATEMENT

WW, LLC has no parent corporations, and no publicly held company owns 10% or more of its stock.

TABLE OF CONTENTS

QUESTION PRESENTED i

DISCLOSURE STATEMENT ii

TABLE OF AUTHORITIES iv

INTRODUCTION 1

STATEMENT 2

REASONS FOR DENYING THE WRIT 7

I. The Manifest-Disregard Standard Under Section 10 of the FAA Has Been Settled Law for Decades. 7

II. *Hall Street* Did Not Foreclose Review for Manifest Disregard Under Section 10. 9

III. There Is No Circuit Split Over Manifest Disregard. 10

IV. The Petition's Predictions About the Impact Of Allowing Review For Manifest Disregard Are Overblown. 17

V. This Case Is A Poor Vehicle For Exploring The Questions Presented. 21

CONCLUSION 23

TABLE OF AUTHORITIES

Amicizia Societa Navegazione v. Chilean Nitrate & Iodine Sales Corp.,
274 F.2d 805 (2d Cir. 1960) 8

Apex Plumbing Supply v. U.S. Supply Co.,
142 F.3d 188 (4th Cir. 1998) 8

Arbitration Between Bosack v. Soward,
___ F.3d ___, 2009 WL 2182898 (9th Cir. 2009) 11, 16

Augusta Capital, LLC v. Reich & Binstock,
2009 WL 2065555 (M.D. Tenn. 2009) 15

B.L. Harbert International v. Hercules Steel Co.,
441 F.3d 905 (11th Cir. 2006) 19

Carter v. Health Net of California,
374 F.3d 830 (9th Cir. 2004) 8

Chisom v. Roemer,
501 U.S. 380 (1991) 18

Citigroup Global Markets, Inc. v. Bacon,
562 F.3d 349 (5th Cir. 2009) 13, 14, 21

Cole v. Burns International Security Services,
105 F.3d 1465 (D.C. Cir. 1997) 20

Comedy Club, Inc. v. Improv West Associates,
553 F.3d 1277 (9th Cir. 2009) 11, 21

Cytyc Corp. v. DEKA Products Ltd. Partnership,
439 F.3d 27 (1st Cir. 2006) 8

Dealer Computer Services, Inc. v. Dub Herring Ford,
547 F.3d 558 (6th Cir. 2008) 15

Dluhos v. Strasberg,
321 F.3d 365 (3d Cir. 2003) 8

Dominion Video Satellite, Inc. v. Echostar Satellite,
430 F.3d 1269 (10th Cir. 2005) 8

First Options of Chicago, Inc. v. Kaplan,
514 U.S. 938 (1995) 7

Flex-Foot, Inc. v. CRP, Inc.,
238 F.3d 1362 (Fed. Cir. 2001) 9

General Dynamics Land System v. Cline,
540 U.S. 581 (2004) 17

George Watts & Son, Inc. v. Tiffany & Co.,
248 F.3d 577 (7th Cir. 2001) 12, 17

Gilmer v. Interstate/Johnson Lane Corp.,
500 U.S. 20 (1991) 19, 20

Grain v. Trinity Health, Mercy Health Services Inc.,
551 F.3d 374 (6th Cir. 2008) 15, 16

Hall Street Associates, L.L.C. v. Mattel, Inc.,
552 U.S. ___, 128 S. Ct. 1396 (2008) ..... *passim*

Health Services Management Corp. v. Hughes,
975 F.2d 1253 (7th Cir. 1992) 8

Hibbs v. Winn,
542 U.S. 88 (2004) 17

Hoeft v. MVL Group,
343 F.3d 57 (2d Cir. 2003) 8

Kashner Davidson Securities Corp. v. Mscisz,
531 F.3d 68 (1st Cir. 2008) 12

Kurke v. Oscar Gruss & Son, Inc.,
454 F.3d 350 (D.C. Cir. 2006) 9

Kyocera Corp. v. Prudential-Bache Trade Services,
341 F.3d 987 (9th Cir. 2003) 8, 10, 12

Martin Marietta Materials, Inc. v. Bank of Oklahoma,
304 Fed. Appx. 360 (6th Cir. 2008) 16

McGrann v. First Albany Corp.,
424 F.3d 743 (8th Cir. 2005) 8

Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.,
473 U.S. 614 (1985) 20

Peebles v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,
431 F.3d 1320 (11th Cir. 2005) 8

Qorvis Communications, LLC v. Wilson,
549 F.3d 303 (4th Cir. 2008) 15

Ramos-Santiago v. United Parcel Service,
524 F.3d 120 (1st Cir. 2008) 12

Sarofim v. Trust Co. of the West,
440 F.3d 213 (5th Cir. 2006) 8

Shearson/America Express, Inc. v. McMahon,
482 U.S. 220 (1987) 7, 20

Solvay Pharmaceuticals v. Duramed Pharmaceuticals,
442 F.3d 471 (6th Cir. 2006) 8

Stolt-Nielsen SA v. Animalfeeds International,
548 F.3d 85 (2d Cir. 2008) 11, 14, 17, 18, 21

Thomas v. Union Carbide Agricultural Products,
473 U.S. 568 (1985) 7

Wilko v. Swan,
346 U.S. 427 (1953) 7

Williams v. Cigna Financial Advisors,
197 F.3d 752 (5th Cir. 1999) 20

Wise v. Wachovia Securities, LLC,
450 F.3d 265 (7th Cir. 2006) 8, 12, 18

STATUTES AND RULES

9 U.S.C. § 10 ..... *passim*

9 U.S.C. § 11 16

Md. Bus. Reg. Code Ann. § 14-216(8)(i) 4

Supreme Court Rule 10 ..... 2, 22

MISCELLANEOUS

Stephanie Mencimer,
Franchise Fraud: Wake Up and Smell the Fine Print, Mother Jones, Feb. 24, 2009, *available at* http://www.motherjones.com/politics/2009/02/franchise-fraud-wake-and-smell-fine-print 3

James E. Berger and Charlene Sun,
Fifth Circuit Addresses 'Manifest Disregard' Review Under Federal Arbitration Act, Paul Hastings, *available at* http://www.paulhastings.com/assets/publications/1265.pdf?wt.mc_ID=1265.pdf. 14

INTRODUCTION

For half a century, federal courts have held that arbitration awards may be set aside in the rare event that an arbitrator manifestly disregards the law. This extremely limited and deferential standard—adopted by every federal circuit—has historically been viewed as an application of Section 10(a)(4) of the Federal Arbitration Act (FAA), because manifest disregard of the law is, by definition, one way in which arbitrators can "exceed[] their powers." 9 U.S.C. § 10(a)(4).

Coffee Beanery wants this Court to jettison that half-century of jurisprudence. It urges the Court to grant certiorari to resolve a purported circuit split over "whether manifest disregard of the law survives *in any form* as a ground for vacating arbitration awards under the FAA." Pet. 3 (emphasis added). The split, the petition contends, has developed since this Court's decision in *Hall Street Associates, L.L.C. v. Mattel, Inc.*, 552 U.S. ___, 128 S. Ct. 1396, 1403 (2008), which held that Section 10 "provide[s] the FAA's exclusive grounds for expedited vacatur."

There is no circuit split. In the 16 months since *Hall Street*, not one circuit has held that the manifest-disregard standard does not survive in any form. No circuit, in other words, follows the approach that Coffee Beanery advocates. On the contrary, the only two circuits to have squarely decided the issue since *Hall Street*—the Second and the Ninth—have held that the manifest-disregard standard remains valid as an application of section 10(a)(4). These courts have taken their cue from *Hall Street* itself, which acknowledged (in a passage the petition conspicuously omits) that manifest disregard may be viewed as "shorthand" for section 10(a)(4). 128 S. Ct. at 1404. Reviewing for manifest dis-

regard as a gloss on section 10(a)(4) is also consistent with pre-*Hall Street* precedent from the Seventh and Ninth Circuits describing manifest disregard as falling comfortably within section 10(a)(4).

No circuit has rejected the approach of the Second, Seventh, and Ninth Circuits. Coffee Beanery's claim of a circuit split rests on the assertion that two circuits—the First and the Fifth—have foreclosed the manifest-disregard standard altogether. But that assertion is incorrect. The First Circuit decision cited in the petition expressly declined to reach that question, and a subsequent First Circuit decision (not mentioned in the petition) in fact reviewed an arbitration award for manifest disregard. Nor has the Fifth Circuit created a split. The Fifth Circuit's careful and narrow decision holds only that manifest disregard is unavailable to the extent that it constitutes an independent, *nonstatutory* ground for vacatur, and leaves for another day the question whether manifest-disregard survives as a gloss on section 10(a)(4). That approach is entirely consistent with the approach of the Second, Seventh, and Ninth Circuits—as the Fifth Circuit itself acknowledged. Finally, the petition mischaracterizes the law of the Fourth and Sixth Circuits, neither of which has produced any published post-*Hall Street* precedent on the question presented.

Absent a split on the first question presented, the petition boils down to a case-specific plea for error correction. But an alleged "misapplication of a properly stated rule of law" is generally not an appropriate ground for certiorari. S. Ct. Rule 10.

STATEMENT

1. Factual Background. After Richard Welshans left his job at a chemical manufacturer in 2003, he and his wife, Deborah Williams, decided to use his severance

package to open a coffee shop in their hometown of Annapolis, Maryland. They arranged to meet with representatives of The Coffee Beanery, a company whose primary business is selling coffee shop franchises. App. 2, 30.[1]

Richard and Deborah attended a "discovery day" for potential franchisees at Coffee Beanery's Michigan headquarters, where they met with the company's vice president, Kevin Shaw. Although the couple went to the meeting interested in a traditional coffee shop franchise, Shaw persuaded them to purchase a full-scale "Café Store," which was far more expensive to open and operate, but which he claimed would be more lucrative. Shaw asked the couple, "Can you get by on $125,000?" and showed them optimistic income projections. App. 3. That same day, they entered into a contract to purchase and operate a Café Store franchise for an initial franchise fee of $25,000. The contract included a mandatory binding arbitration clause.

Coffee Beanery hid from Richard and Deborah the fact that its sales pitch made the café franchises look much more profitable than they actually were. Most of the café shops closed within three years, leaving their owners deep in debt. By the time Richard and Deborah agreed to buy their franchise, approximately 40 café franchises had failed. About 60 more have failed since. The company also concealed the fact that Shaw had been convicted of a felony (grand larceny)—despite a Maryland Franchise Act provision requiring disclosure to

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[1] *See* Stephanie Mencimer, *Franchise Fraud: Wake Up and Smell the Fine Print*, Mother Jones, Feb. 24, 2009, *available at* http://www.motherjones.com/politics/2009/02/franchise-fraud-wake-and-smell-fine-print (detailing Richard and Deborah's experience with Coffee Beanery).

franchisees of felony convictions for "misappropriation of property." Md. Bus. Reg. Code Ann. § 14-216(8)(i).

Richard and Deborah were likewise unaware that Coffee Beanery had experienced serious financial difficulties, and that its business relied on selling franchises and equipment to franchisees at inflated prices. For example, Coffee Beanery required the couple to buy from the company a discontinued lighting system for about $14,000, and a defective display case for $8,000. By 2004, they had been forced to invest approximately $90,000 in personal funds, $300,000 from a Small Business Administration loan, and $40,000 from a home equity loan—just to keep the business afloat. As a result of their experience with Coffee Beanery, Richard and Deborah were eventually forced to mortgage their home and file for bankruptcy.

2. **State Enforcement Action.** In January 2006, in response to Richard and Deborah's case, the Maryland Securities Commissioner issued an administrative order to show cause against the Coffee Beanery and Kevin Shaw, alleging that they had violated the disclosure and anti-fraud provisions of the Maryland Franchise Act. App. 4-5. The Commissioner's claims were nearly identical to those that Richard and Deborah independently brought in this case—that Coffee Beanery had made numerous material misrepresentations in connection with the offer and sale of the Café Store franchises, that Shaw improperly told buyers they could expect a specific income level from the operation of a Café Store, and that Coffee Beanery had failed to timely provide certain required disclosures. *Id.* 5.

In September 2006, the Commissioner, Coffee Beanery, and Shaw entered into a consent order, whereby Coffee Beanery and Shaw acknowledged that

"Coffee Beanery violated . . . the Maryland Franchise Act by making material misrepresentations of fact or omissions of material fact" to prospective Maryland franchisees, and by failing to make required disclosures. *Id.* 34-35. The order required Coffee Beanery and Shaw to cease selling franchises in Maryland unless they complied with the Franchise Act's disclosure requirements and to offer recission to franchisees. *Id.*

3. District-Court and Arbitration Proceedings. One month before the Securities Commissioner's order to show cause, Richard, Deborah, and WW, LLC (the corporation they had formed to run the café) sued Coffee Beanery in federal district court in Maryland. App. 4. In response, Coffee Beanery filed a petition to compel arbitration in federal district court in Michigan. *Id.* 5. The latter court granted the petition and Coffee Beanery commenced arbitration. The Maryland case was stayed pending the outcome of the arbitration.

The arbitrator selected by Coffee Beanery, JoAnne Barron, shared an accountant with Coffee Beanery—a critical conflict of interest given the centrality of Coffee Beanery's accounting to the dispute. Although this conflict was disclosed to the arbitral forum, it was not disclosed to Richard and Deborah until after Barron's appointment. The couple asked that Barron be replaced because "financial disclosures by Coffee Beanery are at issue in this case," but Barron was not removed.

Despite the Securities Commissioner's conclusions, the arbitrator ruled against Richard and Deborah in all respects and found no violations of the Franchise Act. *Id.* 50-58. Barron also ordered Richard and Deborah to pay Coffee Beanery $13,710 in unpaid royalties (which Coffee Beanery had not even requested in its counterclaim) and $187,452 in legal fees and arbitration expenses, including

$16,800 for the arbitrator's services, $35,571 for a court reporter and transcription, and $504 for the Beanery lawyers' lunches. *Id.* 57. The federal district court in Michigan confirmed the award and denied Richard and Deborah's motion to vacate. *Id.* 30-49

4. The Sixth Circuit's Decision. On appeal, Richard and Deborah raised four arguments in favor of vacatur: (1) that the Franchise Act claims fell outside the arbitrator's authority, (2) that the franchise agreement was unconscionable, (3) that the arbitrator had a conflict of interest that rose to the level of bias, and (4) that the arbitrator manifestly disregarded the law. App. 10.

In an unpublished and non-precedential decision, the Sixth Circuit reversed, concluding that the arbitrator manifestly disregarded the law because she "expressly chose not to follow clearly established law regarding the disclosure of Shaw's prior felony." *Id.* 14. The arbitrator, in other words, knew that Maryland law required disclosure of a felony conviction involving "misappropriation of property," but nevertheless refused to follow that law. The panel emphasized that the FAA "expresses a presumption that arbitration awards will be confirmed," and that the applicable standard is "one of the narrowest standards" in "all of American jurisprudence." *Id.* 7-8. In response to Coffee Beanery's petition for rehearing, the panel added a single paragraph discussing *Hall Street*, which the court interpreted as leaving open the possibility of review for manifest disregard of the law. App. 9.

Coffee Beanery again petitioned for rehearing en banc. No judge requested a vote on whether to rehear the case en banc, and the petition was denied. *Id.* 65. The Sixth Circuit has yet to issue a precedential decision concerning the availability of manifest-disregard review under section 10 of the FAA.

REASONS FOR DENYING THE WRIT

I. The Manifest-Disregard Standard Under Section 10 Of The FAA Has Been Settled Law For Decades.

In keeping with its uniform national policy in favor of arbitration, the FAA does not authorize ordinary judicial review of the legal merits of arbitration awards. On the contrary, the Act authorizes federal courts to set aside arbitration awards only under very limited circumstances, including when arbitrators have "exceeded their powers." 9 U.S.C. § 10(a)(4).

For half a century, the federal courts have exercised their authority under section 10 to review arbitration awards for manifest disregard of the law—that is, to determine whether an arbitrator has deliberately refused to follow what he or she knows to be the law. That extremely deferential standard had its genesis in *Wilko v. Swan*, 346 U.S. 427, 436-37 (1953), which contrasted manifest disregard with ordinary judicial review of the merits: "[I]nterpretations of the law by the arbitrators *in contrast to manifest disregard* [of the law] are not subject, in the federal courts, to judicial review for error in interpretation" (emphasis added). This Court recognized the availability of the manifest-disregard standard in several subsequent decisions. *See First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 942 (1995) (listing manifest disregard of the law among the "very unusual circumstances" in which courts will set an arbitrator's decision aside); *Shearson/Am. Exp., Inc. v. McMahon*, 482 U.S. 220, 259 (1987); *Thomas v. Union Carbide Agr. Prods. Co.*, 473 U.S. 568, 601 (1985).

Although courts have often loosely referred to manifest disregard as a "nonstatutory" or "common law" basis for vacatur, the standard has historically been

viewed as an application of the "exceeded their powers" clause of Section 10(a)(4) because manifest disregard of the law is, by definition, one way in which an arbitrator exceeds his or her powers. *See Wise v. Wachovia Sec., LLC*, 450 F.3d 265, 268-69 (7th Cir. 2006) ("[W]e have defined 'manifest disregard of the law' so narrowly that it fits comfortably under the first clause of the fourth statutory ground—'where the arbitrators exceeded their powers.'"); *Kyocera Corp. v. Prudential-Bache Trade Servs.*, 341 F.3d 987, 1002-03 (9th Cir. 2003) ("The 'exceeded their powers' clause of § 10(a)(4) . . . provides for vacatur only when arbitrators purport to exercise powers that the parties did not intend them to possess or otherwise display a manifest disregard of the law."); *Amicizia Societa Navegazione v. Chilean Nitrate & Iodine Sales Corp.*, 274 F.2d 805, 808 (2d Cir. 1960) (first court of appeals decision applying the manifest-disregard standard; describing the standard as a gloss on the "exceeded their powers" clause).

The federal court of appeals—the First through Eleventh, D.C., and Federal Circuits—have unanimously adopted manifest disregard as a valid standard for vacating arbitration awards under the FAA.[2] Contrary to Cof-

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[2] *See Cytyc Corp. v. DEKA Prods. Ltd. P'ship*, 439 F.3d 27, 35 (1st Cir. 2006); *Hoeft v. MVL Group*, 343 F.3d 57, 69 (2d Cir. 2003); *Dluhos v. Strasberg*, 321 F.3d 365, 370 (3d Cir. 2003); *Apex Plumbing Supply v. U.S. Supply Co.*, 142 F.3d 188, 193 (4th Cir. 1998); *Sarofim v. Trust Co. of the West*, 440 F.3d 213, 216-17 (5th Cir. 2006); *Solvay Pharms. v. Duramed Pharm.*, 442 F.3d 471, 475 n.3 (6th Cir. 2006); *Health Servs. Mgmt. Corp. v. Hughes*, 975 F.2d 1253 (7th Cir. 1992); *McGrann v. First Albany Corp.*, 424 F.3d 743, 749 (8th Cir. 2005); *Carter v. Health Net of Cal.*, 374 F.3d 830, 838 (9th Cir. 2004); *Dominion Video Satellite, Inc. v. Echostar Satellite L.L.C.*, 430 F.3d 1269, 1274 (10th Cir. 2005); *Peebles v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, 431 F.3d 1320, 1326 (11th Cir.

(Footnote continued...)

fee Beanery's assertion, no circuit has categorically foreclosed the standard as an application of section 10(a)(4), which should be unsurprising given *Hall Street*'s discussion of manifest disregard.

II. *Hall Street* Did Not Foreclose Review For Manifest Disregard Under Section 10.

Last year, in *Hall Street*, this Court held that federal courts lack authority to vacate arbitration awards under the FAA for reasons other than those enumerated in the statute. *Hall Street*, 128 S. Ct. at 1400 ("We hold that the statutory grounds are exclusive."). The parties in *Hall Street* had agreed by contract to give the district court authority to vacate or modify their arbitration award for insufficient evidence or for ordinary legal errors—grounds not listed in the FAA. *Id.* The question for the Court was whether that aspect of the agreement could be enforced.

In *Hall*, one of the petitioner's arguments in favor of expanded review by contract was that "expandable judicial review authority has been accepted as the law since *Wilko*." *Id.* at 1403. The petitioner read *Wilko* as "recognizing 'manifest disregard of the law' as *a further ground for vacatur on top of those listed in § 10*." *Id.* at 1403 (emphasis added). If courts can add grounds for vacatur, the petitioner argued, then so can contracting parties.

This Court accepted neither the petitioner's argument nor its premise that manifest disregard is untethered to the statute—the same premise on which

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(...continued)
2005); *Kurke v. Oscar Gruss & Son, Inc.*, 454 F.3d 350, 354 (D.C. Cir. 2006); *Flex-Foot, Inc. v. CRP, Inc.*, 238 F.3d 1362, 1365-66 (Fed. Cir. 2001).

Coffee Beanery's petition rests. First, the Court observed that *Wilko*'s reference to manifest disregard "expressly rejects . . . general review for an arbitrator's legal errors." *Id.* at 1404. Second, the Court explained that manifest disregard may properly be viewed not as an additional, nonstatutory ground but as shorthand for those grounds enumerated in section 10. Manifest disregard may refer "to § 10 grounds collectively, rather than adding to them. Or, as some courts have thought, 'manifest disregard' may have been shorthand for § 10(a)(3) or § 10(a)(4), the subsections authorizing vacatur when the arbitrators were 'guilty of misconduct' or 'exceeded their powers.'" *Id.* at 1404 (citing *Kyocera*, 341 F.3d at 997). In other words, the Court recognized that review for manifest disregard of the law may be consistent with Section 10.

Tellingly, Coffee Beanery's petition completely omits *Hall Street*'s recognition that the manifest-disregard standard may properly be regarded as a gloss on Section 10 and its "exceeded their powers" clause. That recognition is fatal to the petition's argument (at 24-27) that the manifest-disregard standard is in "substantial tension" with *Hall Street*. To the contrary, the most that can be said for Coffee Beanery's argument is that *Hall Street* left the manifest-disregard standard open to further development in the circuits. As discussed below, however, no federal circuit since *Hall Street* has adopted the position that Coffee Beanery favors and, hence, there is no circuit split.

III. There Is No Circuit Split Over Manifest Disregard.

The petition contends that there is a "deep, post-*Hall Street* split in the circuits over whether manifest disregard of the law survives in any form as a ground for

vacating arbitration awards under the FAA." Pet. 3. But since *Hall Street* was decided, every reported court of appeals decision to squarely address the issue has held—consistent with *Hall Street*—that the FAA's statutory grounds are the exclusive grounds for vacating an arbitration award. And no circuit has held that the manifest-disregard standard, as an application of Section 10 of the FAA, does not survive *Hall Street*. In short, there is no circuit split (much less a "deep" one).

1. In the 16 months since *Hall Street*, only two circuits have produced precedent squarely addressing whether the manifest-disregard standard survives as an application of the FAA's enumerated grounds for vacatur. As the petition acknowledges (Pet. 4, 20-21) both of those circuits—the Second and the Ninth—have held that manifest-disregard survives as a gloss on Section 10(a)(4), just as this Court suggested in *Hall Street*. *See Arbitration Between Bosack v. Soward*, ___ F.3d ___, 2009 WL 2182898, at *3 (9th Cir. 2009); *Comedy Club, Inc. v. Improv West Assocs.*, 553 F.3d 1277, 1281 (9th Cir. 2009); *Stolt-Nielsen SA v. Animalfeeds Int'l*, 548 F.3d 85, 95 (2d Cir. 2008).[3] That approach is consistent with the pre-*Hall Street* precedent in the Seventh and Ninth Circuits, which had both already held that an appropriately narrow manifest-disregard standard "fits

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[3] On June 15, 2009, this Court granted certiorari in *Stolt-Nielsen* (No. 08-1198). As Coffee Beanery acknowledges, the petition in *Stolt* did not present a question about the manifest-disregard standard's continued vitality; it sought review "only of an unrelated question regarding class arbitration." Pet. 33. Accordingly, there is no reason to hold this case for *Stolt*.

A petition for certiorari concerning whether manifest disregard is a valid standard for vacatur is also pending in *Comedy Club* (No. 08-1525). The petition in that case should be denied for the same reasons as the petition here.

comfortably" within Section 10(a)(4)'s "exceeded their powers" clause. *Wise*, 450 F.3d at 268; *accord Kyocera*, 341 F.3d at 997. No circuit has disagreed.

The petition's claim of a post-*Hall Street* conflict depends entirely on its assertion (at 17-18) that two circuits—the First and Fifth—have broken ranks with the others and held that "manifest disregard of the law is no longer a valid ground under the FAA for vacating an arbitration award." In fact, neither circuit has decided whether the manifest-disregard standard is impermissible as an application of Section 10(a)(4).

The petition's only support for its characterization of the First Circuit's position is one sentence of unexplained dictum in an opinion that expressly "decline[d] to reach the question of whether *Hall Street* precludes a manifest disregard inquiry" because the case was not governed by the FAA. *Ramos-Santiago v. United Parcel Serv.*, 524 F.3d 120, 124 n.3 (1st Cir. 2008).

Worse still, the petition omits a later First Circuit decision vacating an arbitration award for manifest disregard of the law in a case brought under the FAA. *Kashner Davidson Securities Corp. v. Mscisz*, 531 F.3d 68 (1st Cir. 2008). Although it does not address *Hall Street* and echoes pre-*Hall Street* descriptions of manifest disregard as a "common law" standard, *Kashner* also observes that manifest disregard and the FAA's "exceeded their powers" clause may "overlap," *id.* at 77 n.7, and explicitly relies on the Seventh Circuit's narrow articulation of the standard, which is limited by the text of Section 10(a)(4). *Id.* at 77 (citing *George Watts & Son, Inc. v. Tiffany & Co.*, 248 F.3d 577 (7th Cir. 2001)). *Kashner* gives no indication that the First Circuit, when it eventually decides the issue, will reject the other circuits' thus-far uniform understanding of manifest disre-

gard's statutory basis. Because the First Circuit continues to recognize the validity of the manifest-disregard standard, and because it has yet to weigh in on *Hall Street*'s impact, its precedent does not support Coffee Beanery's claim of a circuit split.

The Fifth Circuit's approach in *Citigroup Global Markets, Inc. v. Bacon*, 562 F.3d 349, 358 (5th Cir. 2009), is likewise consistent with that of the Second, Seventh, and Ninth Circuits. *Citigroup*'s holding is carefully limited to whether manifest disregard survives as an independent, *nonstatutory* ground for vacatur. Consistent with *Hall Street*, *Citigroup* holds that "*to the extent that* manifest disregard of the law constitutes a nonstatutory ground for vacatur, it is no longer a basis for vacating awards under the FAA." *Id.* at 355 (emphasis added).

Citigroup expressly did not decide whether the manifest-disregard standard survives as an application of the grounds specified by Section 10 of the FAA. Instead, it remanded to the district court to determine "whether the grounds asserted for vacating the award might support vacatur under any of the statutory grounds"—a step that would have been unnecessary if the court were foreclosing review altogether. *Id.* at 358. On remand, Citigroup renewed its motion to vacate the arbitration award, urging the district court to reassess its manifest-disregard argument under the standard articulated by the Second and Ninth Circuits.[4] That motion is now pending before the United States District Court for the Southern District of Texas.

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[4] *See* Amended Brief in Support of Motion of Citigroup Global Markets, Inc. to Vacate Arbitration Award, Doc. 45, in *Citigroup Global Markets, Inc. v. Bacon*, No. 05-03849 (S.D. Tex).

Although it left the issue open, *Citigroup* recognizes that the Second, Seventh, and Ninth Circuits may be correct that manifest-disregard is permissible as an application of Section 10(a)(4), and that such an approach is consistent with *Hall Street*:

> [M]anifest disregard—as the [Second Circuit in *Stolt-Nielsen*] describes it—does not add to the statutory grounds. The court simply folds manifest disregard into § 10(a)(4). In the full context of the Second Circuit's reasoning, this analysis is not inconsistent with *Hall Street*'s speculation that manifest disregard may, among other things, 'have been shorthand for § 10(a)(3) or § 10(a)(4).'

Id. at 357 (quoting *Hall Street* and citing Second, Seventh, and Ninth Circuit decisions). *Citigroup* goes on to emphasize that this manifest-disregard standard, as limited by Section 10(a)(4), is "very narrow. Because the arbitrator is fully aware of the controlling principle of law and yet does not apply it, he flouts the law in such a manner as to exceed the powers bestowed upon him." *Id.* As some observers have noted, *Citigroup* "suggests that the substance of the doctrine may remain alive in the Fifth Circuit as a component of Section 10(a)(4) of the FAA," just as it does in the circuits that have already decided the issue.[5]

2. In an effort to make the case for a split, Coffee Beanery also overstates dicta in various circuits' post-

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[5]James E. Berger and Charlene Sun, *Fifth Circuit Addresses 'Manifest Disregard' Review Under Federal Arbitration Act*, Paul Hastings, *available at* http://www.paulhastings.com/assets/publications/1265.pdf?wt.mc_ID=1265.pdf.

Hall Street decisions. For example, the petition contends that the Fourth Circuit "implicitly" decided the question presented here in *Qorvis Communications, LLC v. Wilson*, 549 F.3d 303 (4th Cir. 2008). But *Qorvis* merely rejected out of hand the argument that an arbitrator had "manifestly disregarded the law of damages." *Id.* at 311. Because the argument that the arbitrator had manifestly disregarded the law rested on a misunderstanding of the arbitrator's decision, the court did not (and did not need to) discuss the manifest-disregard standard. *Id.*

The petition similarly mischaracterizes the position of the Sixth Circuit, which also has yet to produce a precedent on point. Because the Sixth Circuit decision in this case is unpublished, the petition points to *Dealer Computer Services, Inc. v. Dub Herring Ford*, 547 F.3d 558 (6th Cir. 2008). But that case held that jurisdiction was lacking because the award was not ripe for review. Only a scrap of dictum in a footnote mentions manifest disregard, and even that footnote appears to appropriately contrast vacatur on "non-statutory grounds" with *Hall Street*'s holding. *Id.* at 561 n.2.

More significantly, the petition fails to mention a subsequent Sixth Circuit decision making clear that that, "under *Hall Street*, 'the enumerated grounds in §§ 10 and 11 provide the 'exclusive' grounds for obtaining relief from an arbitration decision." *Grain v. Trinity Health, Mercy Health Services Inc.*, 551 F.3d 374, 379 (6th Cir. 2008); *see Augusta Capital, LLC v. Reich & Binstock, LLP*, 2009 WL 2065555, at * 4 (M.D. Tenn. 2009) (citing *Grain* for that proposition). *Grain* observes that this Court's holding in *Hall Street* casts "doubt on the continuing vitality of [the] theory" that manifest disregard survives as a "'judicially created' supplement to the enumerated forms of FAA relief," and notes *Hall Street*'s recognition that manifest disregard may be un-

derstood as "shorthand" for Section 10. 551 F.3d at 379-80. Nevertheless, *Grain* did not concern a motion for vacatur, but rather a request for modification under 9 U.S.C. § 11, which does not include the "exceeded their powers" language. *Grain* therefore did not decide the question presented for the Sixth Circuit. *See also Martin Marietta Materials, Inc. v. Bank of Oklahoma*, 304 Fed. Appx. 360, 362 (6th Cir. 2008) (assuming, without deciding, that the manifest-disregard standard survives *Hall Street*).[6]

3. In the absence of a circuit split over the questions presented, Coffee Beanery conjures up another circuit split. It claims that the Second, Seventh, and Ninth Circuits have each "adopted a different rule of what manifest disregard includes, creating further conflict in the law." Pet. 20. Because the petition does not present a question concerning the substance of the manifest-disregard standard (as opposed to its availability as a categorical matter), this additional alleged conflict provides no justification for certiorari here.

In any event, the conflict over the standard's scope is nonexistent. The Second, Seventh, and Ninth Circuits all reject the notion that the manifest-disregard standard encompasses judicial review for mere legal errors. *See Bosack*, ___ F.3d ___, 2009 WL 2182898, *4 (explaining that manifest disregard requires much more than "mere error in the law or failure on the part of the arbitrators to understand and apply the law"; it requires that

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[6] The losing party in *Grain* filed a petition for certiorari (No. 08-1446), currently pending before this Court, raising the question whether an arbitration award may be modified (as opposed to vacated) based on the manifest-disregard standard. As the brief in opposition in *Grain* explains, there is no circuit split on that question either. *See* BIO in *Grain v. Trinity Health* (No. 08-1446), at 30-33.

an arbitrator was aware of the law and "intentionally disregarded" it); *Stolt-Nielsen*, 548 F.3d at 95 (adopting Seventh Circuit's admonition that manifest-disregard does not entail "judicial review of the arbitrator's decisions"); *Watts*, 248 F.3d at 579 ("If the parties specify that their dispute is to be resolved under Wisconsin law, then an arbitrator's declaration that he prefers New York law, or no law at all, would violate the terms on which the dispute was given to him for resolution, and thus justify relief").

IV. The Petition's Predictions About The Impact Of Allowing Review For Manifest Disregard Are Overblown.

Coffee Beanery contends that leaving in place limited review of arbitration awards for manifest disregard of the law—a standard that federal courts have been applying for half a century—will have "sweeping national consequences" and threaten the "continued vitality of arbitration." Pet. 28. But it is Coffee Beanery that is seeking a sweeping change, one that has not been adopted by a single circuit. At the very least, given the need for stability and certainty in the arbitration process, the untested nature of Coffee Beanery's preferred approach counsels strongly in favor of allowing the issue to percolate .

If Coffee Beanery is correct, then Congress has stood silently by for 50 years as every federal circuit has radically misinterpreted the FAA. Such "prolonged congressional silence in response to a settled interpretation of a federal statute provides powerful support for maintaining the status quo." *Hibbs v. Winn*, 542 U.S. 88, 112 (2004) (Stevens, J., concurring); *see also Gen. Dynamics Land Sys. v. Cline*, 540 U.S. 581, 594 (2004). Congress's half century of silence "can be likened to the dog that did

not bark." *Chisom v. Roemer*, 501 U.S. 380, 396 n.23 (1991).

The petition, moreover, assumes that the manifest-disregard standard, even when properly limited as a gloss on Section 10(a)(4), allows "judicial review for legal errors." Pet. 28. But it is has been clear at least since *Wilko* that such review is impermissible. And it is even clearer after *Hall Street*, which explains that the FAA reflects a "national policy favoring arbitration with just the limited review needed to maintain arbitration's essential virtue of resolving disputes straigtaway." 128 S. Ct. at 1405 (warning against opening the door to "full-bore legal and evidentiary appeals"). As discussed above, the circuits that have addressed the issue since *Hall Street* have all been emphatic that manifest-disregard under Section 10(a)(4) cannot encompass mere legal error. The petition approvingly quotes Judge Posner's remarks in *Wise*, 450 F.3d at 269, concerning the need to avoid ordinary judicial review of arbitration awards. But *Wise* itself recognizes the validity of manifest disregard of the law as an application of Section 10(a)(4). *Id.* at 268-69. And the Second Circuit's conclusion that manifest-disregard can be appropriate applied under Section 10(a)(4) relied heavily on *Wise*, including the same passage quoted in the petition. *See Stolt-Nielsen*, 548 F.3d at 95.

Despite the petition's dire predictions about the potential for merits-based review, Coffee Beanery cannot deny that federal-court vacatur of an arbitration award for manifest disregard is extraordinarily rare, having occurred in only a handful of reporting federal decisions in the more than 50 years the doctrine has been applied by the courts. The rarity of vacatur underscores the lack of importance of the questions presented.

The petition suggests that the mere availability of the manifest-disregard standard encourages losing parties to challenge arbitral awards, even where doing so is frivolous. Coffee Beanery's solution to this perceived problem is to cut off this avenue of review altogether. The only authority the petition cites for the argument that frivolous challenges are becoming a problem is *B.L. Harbert Int'l v. Hercules Steel Co.*, 441 F.3d 905, 913 (11th Cir. 2006), which discussed what to do "[w]hen a party who loses an arbitration award assumes a never-say-die attitude and drags the dispute through the court system without an objectively reasonable belief that it prevail[.]" *Id.* But *Harbert* does not say such frivolous claims are any more common than other kinds of frivolous claims. More importantly, *Harbert* proposes a very different solution than does petitioner—namely, "insist[ing] that if a party on the short end of an arbitration award attacks that award in court without any real legal basis for doing so, that party should pay sanctions." *Id.* The availability of such ordinary remedies for abusive litigation underscores the lack of any need for this Court's review.

Moreover, while the Eleventh Circuit's threat of sanctions may be severe, it is far less extreme than the approach proposed by the petition. Coffee Beanery's position, if accepted, would eliminate any safety valve for the rare case in which an arbitrator truly strays beyond the bounds of his or her authority. The presence of such a safety value bolsters the integrity of, and public confidence in, the alternative dispute resolution process as a whole.

Such a safety valve is also particularly important in cases such as this one, in which there is a risk that, absent any possibility of review, statutory rights will be devalued. Thus, in *Gilmer v. Interstate/Johnson Lane*

Corp., 500 U.S. 20 (1991), this Court held that cases involving statutory rights are subject to arbitration, but rested that conclusion on two fundamental assumptions about how arbitration would operate in such cases. First, "by agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial forum." *Id.* at 26 (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985)). Second, "'although judicial scrutiny of arbitration awards necessarily is limited, *such review is sufficient to ensure that arbitrators comply with the requirements of the statute' at issue.*" *Id.* at 32 n.4 (quoting *Shearson/American Express v. McMahon*, 482 U.S. at 232) (emphasis added)).

As the courts of appeals have recognized, "[t]hese twin assumptions regarding the arbitration of statutory claims are valid only if judicial review under the 'manifest disregard of the law' standard is sufficiently rigorous" to ensure that arbitrators do not exceed their authority under a given statute. *Cole v. Burns Int'l Sec. Servs.*, 105 F.3d 1465, 1487 (D.C. Cir. 1997); *see also Williams v. Cigna Fin. Advisors*, 197 F.3d 752, 761 (5th Cir. 1999) ("The federal courts and courts of appeals are charged with the obligation to exercise sufficient judicial scrutiny to ensure that arbitrators comply with their duties and the requirements of the statutes."). By proposing to discard the manifest-disregard standard, petitioner seeks to eliminate a fundamental protection on which the arbitrability of statutory claims is premised.

Petitioner's attempt to discard the manifest-disregard standard would overturn the law of every circuit and call into question the settled expectation that statutory claims are subject to mandatory arbitration. An established consensus in the lower courts, supported

by statements of this Court, should not be overturned merely because a litigant is dissatisfied with the application of the law to the facts of its case.

V. This Case Is A Poor Vehicle For Exploring The Questions Presented.

Even apart from the complete absence of a circuit split on the first question presented, this case is a poor vehicle for exploring whether the manifest-disregard standard is valid in any form.

At the very least, this Court should await a case in which the court below has thoroughly analyzed, and created precedent, on the question presented. The decision below has little discussion of the statutory basis for the manifest-disregard standard, and the panel did not have the benefit of the more thorough analysis in cases such as *Stolt-Nielsen*, *Comedy Club*, and *Citigroup*. *See Citigroup*, 562 F.3d at 356 (noting that "*Coffee Beanery* only briefly considered the effect of *Hall Street* on manifest disregard of the law."). Moreover, the decision below is unpublished and the Sixth Circuit has yet to provide a definitive answer concerning the availability of manifest-disregard review under Section 10(a)(4). The Court should also wait until at least one circuit has adopted Coffee Beanery's theory. In the absence of such a decision, review would not only be premature and unnecessary, but unfocused and without the benefits of a full airing in the lower courts.

This case is also poor vehicle because it involves several alternative, factbound grounds for vacatur. The petition contends that this case is an acceptable vehicle because "[t]he arbitrator here did not resolve a claim outside the scope of the agreement"—an action that "all Circuits would agree would exceed the arbitrators powers under § 10(a)(4) of the FAA." Pet. 32-33. But, in fact,

respondents' principal argument below was that "the Arbitrator overreached her authority when she ruled on the Franchise Act claims," despite a contract provision providing otherwise. App. 32. Respondents also argued that "the Arbitrator had a conflict of interest that rose to the level of bias"—namely, that she shared an accountant with Coffee Beanery, and issued an award that critically depended on her assessment of the credibility of that accountant. *Id.*; 9 U.S.C. § 10(a)(2) (authorizing vactur for "evident partiality"). The existence of compelling alternative grounds for vacatur makes it likely that review of the Sixth Circuit's formulation of the manifest-disregard standard would not be dispositive.

Finally, to the extent that the petition seeks to take the Sixth Circuit to task solely for its description of the proper basis for the manifest-disregard standard (statutory versus non-statutory), that request is a purely academic exercise unworthy of this Court's review. This Court does not sit to police dicta in unpublished decisions. Likely for this reason, the petition also includes a second question presented, seeking review of the case-specific application of the manifest-disregard standard to the facts. Pet. ii. But certiorari is inappropriate where, as here, the asserted error consists of no more than "the misapplication of a properly stated rule of law." S. Ct. Rule 10.

CONCLUSION

The petition for a writ of certiorari should be denied.

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In The

Supreme Court of the United States

THE COFFEE BEANERY, LTD., ET AL.,

Petitioners,

v.

WW, LLC; RICHARD WELSHANS;
AND DEBORAH WILLIAMS,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

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TABLE OF CONTENTS

Page

TABLE OF CONTENTS i

TABLE OF AUTHORITIES ii

REPLY 1

I. Respondents Cannot Explain Away The Deep, Square Conflict In The Circuits Over Manifest Disregard Of The Law 2

A. The First and Fifth Circuits have rejected manifest disregard 4

B. The Sixth Circuit insists that manifest disregard is a viable extra-statutory ground for vacatur 7

C. The Second, Seventh, and Ninth Circuits construe manifest disregard as a gloss on FAA § 10(a)(4) but disagree on the parameters of the doctrine 8

II. The History Of This Case Illustrates The Need For Review Without Further Delay ... 9

III. This Case Is An Ideal Vehicle For Deciding The Questions Presented 11

CONCLUSION 14

TABLE OF AUTHORITIES

Page

FEDERAL CASES

ALS & Assocs. v. *AGM Marine Constructors, Inc.*, 557 F. Supp. 2d 180 (D. Mass. 2008).....6, 10

AmeriCredit Fin. Servs. v. *Oxford Mgmt. Servs.*, No. 07-CV-3948, 2008 U.S. Dist. LEXIS 76720 (E.D.N.Y. Sept. 18, 2008).....10

Buckeye Check Cashing, Inc. v. *Cardegna*, 546 U.S. 440 (2006).....11

Citigroup Global Mkts. Inc. v. *Bacon*, 562 F.3d 349 (CA5 2009).....3, 5

Comedy Club, Inc. v. *Improv W. Assocs.*, 553 F.3d 1277 (CA9 2009), cert. pending No. 08-1525 8

Dealer Computer Servs. v. *Dub Herring Ford*, 547 F.3d 558 (CA6 2008).....7

DMA Int'l, Inc. v. *Qwest Commc'ns Int'l*, No. 08-CV-00358, 2008 U.S. Dist. LEXIS 76164 (D. Colo. Sept. 12, 2008) 10

E. Seaboard Constr. Co. v. *Gray Constr., Inc.*, 553 F.3d 1 (CA1 2008).....6

Franko v. *Ameriprise Fin. Servs.*, No. 09-09, 2009 U.S. Dist. LEXIS 48907 (E.D. Pa. June 11, 2009) 1, 10

Global Reinsurance Corp. of Am. v. *Argonaut Ins. Co.*, No. 07 Civ. 7514, 2009 U.S. Dist. LEXIS 37460 (S.D.N.Y. Mar. 23, 2009) 5

TABLE OF AUTHORITIES – Continued

Page

Globe Newspaper Co. v. *Int'l Ass'n of Machinists*, No. 08-cv-11945, 2009 U.S. Dist. LEXIS 69034 (D. Mass. Aug. 5, 2009) 6

Grain v. *Trinity Health*, 551 F.3d 374 (CA6 2008) 7

Halim v. *Great Gatsby's Auction Gallery, Inc.*, 516 F.3d 557 (CA7 2008) 8

Hall Street Associates, L.L.C. v. *Mattel, Inc.*, 552 U.S. ___, 128 S. Ct. 1396 (2008) ..... *passim*

Halliburton Energy Servs. v. *NL Indus.*, 306 Fed. Appx. 843 (CA5 2009) 10

Hartford Fire Ins. Co. v. *Evergreen Org., Inc.*, No. 07 Civ. 7977, 2008 U.S. Dist. LEXIS 69301 (S.D.N.Y. Aug. 28, 2008) 10

Horizon Lines of P.R., Inc. v. *Local 1575, Int'l Longshoremen's Ass'n*, No. 08-1611, 2009 U.S. Dist. LEXIS 17637 (D.P.R. Mar. 6, 2009) 6

I.N.S. v. *Aguirre-Aguirre*, 526 U.S. 415 (1999) 11

Johnson v. *Home State Bank*, 501 U.S. 78 (1991) 11

Jones v. *PPG Indus.*, No. 07cv1537, 2009 U.S. Dist. LEXIS 20363 (W.D. Pa. Mar. 13, 2009) 10

Kashner Davidson Secs. Corp. v. *Mscisz*, 531 F.3d 68 (CA1 2008) 6

Nat'l Resort Mgmt. Corp. v. *Cortez*, 319 Fed. Appx. 313 (CA5 2009) 5

TABLE OF AUTHORITIES – Continued

Page

O'Leary v. *Salomon Smith Barney, Inc.*, No. 05-6016, 2008 U.S. Dist. LEXIS 98483 (D.N.J. Dec. 5, 2008) 10

Ramos-Santiago v. *United Parcel Serv.*, 524 F.3d 124 (CA1 2008) 5, 6

Regnery Publ., Inc. v. *Miniter*, 601 F. Supp. 2d 192 (D.D.C. 2009) 10

Saipem Am. v. *Wellington Underwriting Agencies*, No. 08-20247, 2009 U.S. App. LEXIS 12673 (CA5 June 9, 2009) 5

Stolt-Nielsen SA v. *AnimalFeeds Int'l Corp.*, 548 F.3d 85 (CA2 2008) 8

Travelers Indem. Co. v. *Bailey*, 129 S. Ct. 2195 (2009) 11

United Paperworkers Int'l Union v. *Misco, Inc.*, 484 U.S. 29 (1987) 10

United States v. *Mendenhall*, 446 U.S. 544 (1980) 12

Waddell v. *Holiday Isle, LLC*, No. 09-0040, 2009 U.S. Dist. LEXIS 67669 (S.D. Ala. Aug. 4, 2009) 5, 10

Wilko v. *Swan*, 346 U.S. 427 (1953) 3, 4

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TABLE OF AUTHORITIES – Continued

Page

STATE CASES

Moncharsh v. *Heily & Blase*, 832 P.2d 899 (Cal. 1992) 13

Transmontaigne Prod. Servs. v. *Americas Ins. Co.*, No. 49A05-0810-CV-604, 2009 Ind. App. Unpub. LEXIS 1008 (Ind. Ct. App. Aug. 12, 2009) 1

Xtria L.L.C. v. *Int'l Ins. Alliance*, 286 S.W.3d 583 (Tex. App. 2009) 1, 10

RULES

S. Ct. R. 14.1(a) 12

OTHER AUTHORITIES

Hiro N. Aragaki, *The Mess of Manifest Disregard*, 119 Yale L.J. Online ___ (forthcoming 2009) 2

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TABLE OF AUTHORITIES – Continued

Page

Richard C. Reuben, *Building the Civilization of Arbitration: Personal Autonomy and Vacatur after* Hall Street, 113 Penn. St. L. Rev. 1103 (2009) 2

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REPLY

Since Coffee Beanery filed its petition four months ago, still more courts, in addition to those cited in the petition for certiorari (Pet. 16-17), have concluded that the circuits are split over whether manifest disregard survives *Hall Street Associates, L.L.C.* v. *Mattel, Inc.*, 552 U.S. ___, 128 S. Ct. 1396 (2008), and, if it does survive, how to define and apply it. *See Franko* v. *Ameriprise Fin. Servs.*, No. 09-09, 2009 U.S. Dist. LEXIS 48907, at *14 n.5 (E.D. Pa. June 11, 2009); *Transmontaigne Prod. Servs.* v. *Americas Ins. Co.*, No. 49A05-0810-CV-604, 2009 Ind. App. Unpub. LEXIS 1008, at *18 n.11 (Ind. Ct. App. Aug. 12, 2009); *Xtria L.L.C.* v. *Int'l Ins. Alliance*, 286 S.W.3d 583, 593 (Tex. App. 2009).

In the same short time, five academic articles have recognized the circuit split and have called on this Court to resolve it:

> Some courts have held that manifest disregard is dead after *Hall Street* because it is not a ground that is expressly included in the Section 10(a) grounds for vacatur. At the same time, some courts have held that manifest disregard does survive *Hall Street*. . . . Still other courts have simply found that it is an open question.
>
> Clearly, the U.S. Supreme Court is going to need to step in to resolve the schism in the lower courts and to settle the question once and for all.

Richard C. Reuben, *Building the Civilization of Arbitration: Personal Autonomy and Vacatur after* Hall Street, 113 Penn. St. L. Rev. 1103, 1145-46 (2009) (footnotes omitted); *see also* Hiro N. Aragaki, *The Mess of Manifest Disregard*, 119 Yale L.J. Online ___ (forthcoming 2009); Jane B. Morgan, *The Arbitration Exception in Third Party Legal Opinions: Dead or Alive?*, 28 Miss. C. L. Rev. 249, 252-53 (2009); Hans Smit, Hall Street Associates v. Mattel: *A Critical Comment*, 17 Am. Rev. Int'l Arb. 513, 519 (2006 [sic]); Robert Ellis, Recent Development, *Imperfect Minimalism: Unanswered Questions in* Hall Street Associates L.L.C. v. Mattel, Inc., *138 S. Ct. 1396 (2008)*, 32 Harv. J.L. & Pub. Pol'y 1187, 1192 (2009).

The recognition by these courts and commentators of a deep split in the circuits directly refutes Respondents' claim that no split exists.

I. Respondents Cannot Explain Away The Deep, Square Conflict In The Circuits Over Manifest Disregard Of The Law.

Despite all evidence to the contrary, Respondents argue that "[t]here is no circuit split," BIO 1, based on the twin premises that the doctrine of manifest disregard has "historically been viewed as an application of Section 10(a)(4) of the Federal Arbitration Act," *ibid.*, and that this Court endorsed that view in *Hall Street*, holding "that the manifest-disregard standard may properly be regarded as a gloss on

Section 10 and its 'exceeded their powers' clause." BIO 10. Respondents' claims about history and *Hall Street* are both wrong, and so is their argument on the circuit split.

As to history, after this Court used the phrase "manifest disregard" in dictum in *Wilko* v. *Swan*, 346 U.S. 427, 436 (1953), every circuit but one adopted it in some form as an extra-statutory, common law doctrine. Pet. 26-27 (citing cases from each circuit); *see Citigroup Global Mkts. Inc.* v. *Bacon*, 562 F.3d 349, 353-55 (CA5 2009) (describing the history of the doctrine's adoption). The pre-*Hall Street* cases that Respondents cite to support their unfounded claim of uniformity (BIO 8 & n.2) either recognize that manifest disregard exists in addition to the grounds for vacatur in FAA § 10(a), conduct separate analyses for § 10(a) and for manifest disregard, or fail to mention § 10(a) at all in discussing manifest disregard.

As to *Hall Street*, it did not hold "that manifest disregard may properly be viewed . . . as shorthand for those grounds enumerated in section 10," as Respondents wrongly claim. BIO 10. In the *Hall Street* passage Respondents quote, the Court listed various things that *Wilko*'s dictum "may have" meant to demonstrate "the vagueness" of its "phrasing" and to prove that the dictum did not have the significance Hall Street argued it did. 128 S. Ct. at 1404. Far from endorsing any particular meaning as the proper one, the Court distanced itself from *Wilko*, saying that "[w]e, when speaking as a Court, have merely taken

the *Wilko* language as we found it, without embellishment." *Ibid.*

Finally, there *is* a split in the circuits because of the irreconcilable conflict between this Court's holding in *Hall Street* that § 10 "provide[s] the FAA's exclusive grounds for expedited vacatur," 128 S. Ct. at 1403, and the settled understanding of manifest disregard as a common law doctrine. The lower courts have been forced to choose between holding fast to the common law roots of manifest disregard (the Sixth Circuit), trying to squeeze the common law doctrine into the text of § 10(a)(4) (the Second and Ninth Circuits), rejecting the doctrine in favor of applying the text of § 10(a)(4) on its own terms (the First and Fifth Circuits), and retaining the doctrine in name only, but applying it in a way that is in fact limited to the text (the Seventh Circuit). *See* Pet. 16-23.

A. The First and Fifth Circuits have rejected manifest disregard.

Straining to smooth out the conflict recognized by numerous courts and commentators, Respondents mischaracterize the positions the circuits have taken, beginning with the two circuits that have rejected manifest disregard altogether. The Fifth Circuit did not "carefully limit[]" its holding "to whether manifest disregard survives as an independent, *nonstatutory* ground for vacatur," as Respondents claim. BIO 13. It concluded that the very phrase

"manifest disregard," "as a term of legal art, is no longer useful in actions to vacate arbitration awards." *Citigroup*, 562 F.3d at 358. Later decisions from the Fifth Circuit interpret *Citigroup* as eliminating manifest disregard altogether. *See Saipem Am.* v. *Wellington Underwriting Agencies*, No. 08-20247, 2009 U.S. App. LEXIS 12673, at *7 & n.3 (CA5 June 9, 2009); *Nat'l Resort Mgmt. Corp.* v. *Cortez*, 319 Fed. Appx. 313, 313 (CA5 2009). Other courts, more numerous than petitioners have room to cite in this reply, interpret *Citigroup* in the same way. *See, e.g.*, *Waddell* v. *Holiday Isle, LLC*, No. 09-0040, 2009 U.S. Dist. LEXIS 67669, at *23 (S.D. Ala. Aug. 4, 2009); *Global Reinsurance Corp. of Am.* v. *Argonaut Ins. Co.*, No. 07 Civ. 7514, 2009 U.S. Dist. LEXIS 37460, at *10 (S.D.N.Y. Mar. 23, 2009).

Respondents also misrepresent the position of the First Circuit when they argue that *Ramos-Santiago* "expressly 'decline[d] to reach the question of whether *Hall Street* precludes a manifest disregard inquiry.'" BIO 12. In fact, *Ramos-Santiago* declared "that manifest disregard of the law is not a valid ground for vacating or modifying an arbitral award in cases brought under the Federal Arbitration Act ('FAA')." *Ramos-Santiago* v. *United Parcel Serv.*, 524 F.3d 124, 124 n.3 (CA1 2008). The question the court "decline[d] to reach" was whether *Hall Street* also precludes a manifest disregard inquiry under the Labor Management Relations Act. *Ibid.* Lower courts in the First Circuit have consistently interpreted *Ramos-Santiago* to preclude the use of manifest

disregard under the FAA. *See, e.g.*, *Globe Newspaper Co.* v. *Int'l Ass'n of Machinists*, No. 08-cv-11945, 2009 U.S. Dist. LEXIS 69034, at *10 n.5 (D. Mass. Aug. 5, 2009); *ALS & Assocs.* v. *AGM Marine Constructors, Inc.*, 557 F. Supp. 2d 180, 185 (D. Mass. 2008).

The First Circuit's subsequent decision in *Kashner Davidson Secs. Corp.* v. *Mscisz*, 531 F.3d 68 (CA1 2008), does not revive manifest disregard, as Respondents claim, BIO 11-12, because it does not discuss either *Hall Street* or *Ramos-Santiago*. *Kashner* was briefed and argued before *Hall Street* issued, neither party submitted *Hall Street* as supplemental authority, and the opinion does not cite, much less discuss *Hall Street*. *See Kashner Davidson Sec. Corp.* v. *Mscisz*, No. 09-1356, Reply Brief for Defendants-Appellants at 4 (CA1 Aug. 14, 2009) (reply brief on second appeal after remand, recounting history of first appeal). Another subsequent First Circuit decision similarly cites pre-*Hall Street* authority on manifest disregard without discussing *Hall Street* or *Ramos-Santiago* and thus similarly does not affect the issue presented in this petition. *See E. Seaboard Constr. Co.* v. *Gray Constr., Inc.*, 553 F.3d 1, 4 (CA1 2008). The only First Circuit district court to cite *Kashner* concluded that *Ramos-Santiago* was controlling and that "the court [in *Hall Street*] rejected the 'manifest disregard of the law' standard of review in cases filed under the provisions of the federal arbitration statute." *Horizon Lines of P.R., Inc.* v. *Local 1575, Int'l Longshoremen's Ass'n*,

No. 08-1611, 2009 U.S. Dist. LEXIS 17637, at *9 (D.P.R. Mar. 6, 2009).

B. The Sixth Circuit insists that manifest disregard is a viable extra-statutory ground for vacatur.

It is ironic that Respondents contend that the Sixth Circuit "has yet to produce a precedent on point," BIO 15, because the panel below ruled as it did based on its belief that it was bound by precedent: "[I]t would be imprudent to cease. . . . follow[ing] [the Sixth Circuit's] well-established precedent" on manifest disregard. App. 10. The panel squarely addressed whether manifest disregard remains an extra-statutory basis for vacatur after *Hall Street*, and concluded that it does. App. 8. In addition, as petitioners noted, a prior published decision in the Sixth Circuit also declared that a court may "vacate an award on non-statutory grounds if the arbitration panel demonstrates a 'manifest disregard of the law.'" *Dealer Computer Servs.* v. *Dub Herring Ford*, 547 F.3d 558, 561 n.2 (CA6 2008).[1]

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[1] Respondents devote a paragraph to *Grain* v. *Trinity Health*, 551 F.3d 374 (CA6 2008), before acknowledging that "*Grain* did not concern a motion for vacatur," and hence that it "did not decide the question presented for the Sixth Circuit." BIO 16. *Grain* is irrelevant to the question before the Court.

C. The Second, Seventh, and Ninth Circuits construe manifest disregard as a gloss on FAA § 10(a)(4) but disagree on the parameters of the doctrine.

Respondents assert that "the conflict over the standard's scope" in the Second, Seventh, and Ninth Circuits "is nonexistent" because no court allows "judicial review for mere legal errors." BIO 16. This ignores the real circuit conflict that exists. The Seventh Circuit holds that "[f]actual or legal error, *no matter how gross*, is insufficient to support overturning an arbitration award." *Halim* v. *Great Gatsby's Auction Gallery, Inc.*, 516 F.3d 557, 563 (CA7 2008) (emphasis added). In practice, it is therefore closely aligned with the First and Fifth Circuits. The other two circuits disagree with the Seventh Circuit and allow some degree of legal error to justify vacating an award. In the Second Circuit, there must be an "egregious impropriety," such as when the "arbitrator explicitly rejected controlling precedent" or when the arbitrator "willfully flouted the governing law by refusing to apply it." *Stolt-Nielsen SA* v. *AnimalFeeds Int'l Corp.*, 548 F.3d 85, 92, 93 (CA2 2008). In the Ninth Circuit, the arbitrator need only be "fundamentally incorrect" in applying the law. *Comedy Club, Inc.* v. *Improv W. Assocs.*, 553 F.3d 1277, 1290, 1293 (CA9 2009), cert. pending, No. 08-1525. To claim that this conflict is "nonexistent" is to ignore reality: litigants face materially different standards in different circuits.

II. The History Of This Case Illustrates The Need For Review Without Further Delay.

The Court should grant review to resolve the circuit split now, because as long as losing parties in arbitration perceive that courts will entertain arguments of legal error through the doctrine of manifest disregard of the law, arbitration's core benefits of finality and efficiency will be undermined. Pet. 28-31.

The history of this case richly illustrates the danger. After an eleven-day hearing, the arbitrator fully vindicated Coffee Beanery on all counts. That was in March of 2007. App. 50-58. Respondents then moved to vacate the award in the district court, moved for reconsideration when they lost, and appealed to the Sixth Circuit when they lost again. Coffee Beanery was required to defend the award in the district court, defend it again in the Sixth Circuit, petition for rehearing when the Sixth Circuit held that manifest disregard of the law survived *Hall Street*, and petition this Court for review when the Sixth Circuit denied relief. Now it is September of 2009. Coffee Beanery has been forced to defend the arbitration award for more than two years in three levels of federal court.[2]

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[2] In this Court, moreover, Respondents write their brief in opposition as if the arbitrator had never ruled, offering a statement of facts drawn, not from the record, but from a political news article, BIO 2-3 & n.1, even though it is settled law that an arbitrator's factual findings are binding. *See, e.g.*,

(Continued on following page)

Coffee Beanery's experience is, unfortunately, a common one. Since *Hall Street*, losing parties in arbitration repeatedly have raised, lower courts have had to consider, and winning parties have had to defend against arguments based on manifest disregard of the law.[3]

The unsettled state of the law, and the resulting inefficiency in confirming arbitration awards, flows from this Court's cases and can only be corrected here. This Court's dictum in *Wilko* gave rise to manifest disregard. This Court's holding in *Hall Street* eliminated the only basis courts historically gave for manifest disregard and threw the lower courts into conflict. Manifest disregard plays too pervasive a role

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United Paperworkers Int'l Union v. *Misco, Inc.*, 484 U.S. 29, 37-38 (1987).

[3] *See, e.g.*, *Halliburton Energy Servs.* v. *NL Indus.*, 306 Fed. Appx. 843, 843 (CA5 2009); *Waddell*, 2009 U.S. Dist. LEXIS 67669, at *23; *Franko*, 2009 U.S. Dist. LEXIS 48907, at *15; *Jones* v. *PPG Indus.*, No. 07cv1537, 2009 U.S. Dist. LEXIS 20363, at *4 n.1 (W.D. Pa. Mar. 13, 2009); *Regnery Publ., Inc.* v. *Miniter*, 601 F. Supp. 2d 192, 196 (D.D.C. 2009); *Williams* v. *Mexican Rest., Inc.*, No. 1:05-CV-841, 2009 U.S. Dist. LEXIS 16561, at *21 (E.D. Tex. Feb. 27, 2009); *O'Leary* v. *Salomon Smith Barney, Inc.*, No. 05-6016, 2008 U.S. Dist. LEXIS 98483, at *9 (D.N.J. Dec. 5, 2008); *DMA Int'l, Inc.* v. *Qwest Commc'ns Int'l*, No. 08-CV-00358, 2008 U.S. Dist. LEXIS 76164, at *13 (D. Colo. Sept. 12, 2008); *Hartford Fire Ins. Co.* v. *Evergreen Org., Inc.*, No. 07 Civ. 7977, 2008 U.S. Dist. LEXIS 69301, at *14 n.3 (S.D.N.Y. Aug. 28, 2008); *AmeriCredit Fin. Servs.* v. *Oxford Mgmt. Servs.*, No. 07-CV-3948, 2008 U.S. Dist. LEXIS 76720, at *18 (E.D.N.Y. Sept. 18, 2008); *ALS & Assocs.*, 557 F. Supp. 2d at 185; *Xtria L.L.C.*, 286 S.W.3d at 594.

in the fights to vacate arbitration awards for the Court to stay its hand any longer.

III. This Case Is An Ideal Vehicle For Deciding The Questions Presented.

Respondents do not address any of Coffee Beanery's six reasons why this case is an ideal vehicle for deciding the questions presented, Pet. 31-35, and the supposed vehicle problems they identify are baseless.[4] The unpublished status of the decision below is not a vehicle problem. *Hall Street* itself reviewed an unpublished decision, 128 S. Ct. at 1401, n.1, and fully ten percent of the Court's decisions last Term reviewed unpublished decisions. Respondents' claimed preservation of other arguments for vacating the award that might be raised on remand is also not a vehicle problem. This Court often decides the question presented and then remands for the lower court to consider alternative arguments. *See, e.g.*, *Travelers Indem. Co.* v. *Bailey*, 129 S. Ct. 2195, 2198 (2009); *I.N.S.* v. *Aguirre-Aguirre*, 526 U.S. 415, 433 (1999); *Johnson* v. *Home State Bank*, 501 U.S. 78, 88 (1991). Alternative arguments pose a vehicle problem only if the lower court addressed and relied on them, and it is undisputed here that the Sixth Circuit relied solely on manifest disregard as the basis for vacatur. This

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[4] The brief in opposition also does not defend the Sixth Circuit's error below in remanding for litigation instead of further proceedings before the arbitrator, as required by *Buckeye Check Cashing, Inc.* v. *Cardegna*, 546 U.S. 440, 446 (2006).

case is an ideal vehicle for addressing the questions presented by the petition.

Respondents also argue that this case is a poor vehicle for considering the full scope of the conflict in the circuits "[b]ecause the petition does not present a question concerning the substance of the manifest-disregard standard[.]" BIO 16. That is incorrect. "The statement of any question presented is deemed to comprise every subsidiary question fairly included therein," S. Ct. R. 14.1(a), including questions that are "essential to the correct disposition of the other issues in the case." *United States* v. *Mendenhall*, 446 U.S. 544, 552 n.5 (1980). The Court cannot decide the questions presented in this petition – whether manifest disregard of the law is a valid common-law or statutory ground for vacating an arbitration award under the FAA, and whether the Sixth Circuit erred below in vacating the arbitration award for manifest disregard of the law – without determining what the standard for manifest disregard is. That question is inherent in, and essential to the correct disposition of, the questions presented. Moreover, this Court has the discretion to craft its own questions presented and should do so if it would help present the full scope of the conflict.

Finally, Respondents accuse Coffee Beanery of "seeking a sweeping change" in the law and argue on that ground for denial of review. BIO 17. This is a merits argument, not an argument affecting review. This Court, moreover, already effected the change in *Hall Street* when it held that § 10 "provide[s] the

FAA's exclusive grounds for expedited vacatur." 128 S. Ct. at 1403. What remains is only to apply *Hall Street*'s holding to the doctrine of manifest disregard and to confirm the position already adopted by the First, Fifth, and Seventh Circuits – a position that has been applied for years by many state courts under their own arbitration statutes. *See, e.g.*, *Moncharsh* v. *Heily & Blase*, 832 P.2d 899, 904, 914-15 (Cal. 1992).

CONCLUSION

The petition for a writ of certiorari should be granted.

Dated: September 8, 2009

Respectfully submitted,

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In The Supreme Court of the United States

THE COFFEE BEANERY LTD., ET AL.,

Petitioners,

v.

WW, LLC; RICHARD WELSHANS; AND DEBORAH WILLIAMS,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

BRIEF OF THE INTERNATIONAL FRANCHISE ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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TABLE OF CONTENTS

	Page
STATEMENT OF INTEREST	1
SUMMARY OF THE ARGUMENT	2
ARGUMENT	3
I. Franchising Has a Substantial Impact on the U.S. Economy	3
II. Many Franchise Systems Rely on Arbitration as a Cost-Effective and Efficient Means of Resolving Disputes	4
III. The Current Circuit Split Threatens to Undermine the Finality and Cost-Effectiveness of Arbitration for National Franchise Systems	6
IV. The Time Is Ripe for this Court to Resolve the Proper Bounds of Any Manifest Disregard Standard for Vacating Arbitration Awards	9
V. The Sixth Circuit Decision Also Conflicts With this Court's Precedents	12
CONCLUSION	14

TABLE OF AUTHORITIES

Page

CASES

Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265 (1995) 5

Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440 (2006) 13

Hall Street Associates L.L.C. v. Mattel, Inc., 128 S. Ct. 1396 (2008) ..... *passim*

Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985) 5

Nagrampa v. MailCoups, Inc., 469 F.3d 1257 (9th Cir. 2006) 7, 13

NetKnowledge Techonolgies, L.L.C. v. Rapid Transmit Technologies, 2007 WL 518548 at *3-5 (N.D. Tex. 2007), *aff'd*, 269 Fed. Appx. 443 (5th Cir. 2008) 11

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Vaden v. Discover Bank, 129 S. Ct. 1262 (2009) 3, 8

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TABLE OF AUTHORITIES – Continued

Page

STATUTES

9 U.S.C. § 10 9

Federal Arbitration Act, 9 U.S.C. §§ 1-16 2

RULES

16 C.F.R. 436.1(q) 6

S. Ct. R. 37.6 1

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TABLE OF AUTHORITIES – Continued

Page

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Christopher R. Drahozal & Quentin R. Wittrock, *Is there a Flight from Arbitration?*, 37 HOFSTRA L. R. 71, 75 (2008) 4, 6, 7

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STATEMENT OF INTEREST

The International Franchise Association ("IFA") submits this brief as *amicus curiae* in support of the petition for a writ of certiorari filed by the Coffee Beanery Ltd.[1]

Founded in 1960, the IFA is the oldest and largest trade association in the world devoted to representing the interests of franchising. The IFA is a membership organization of franchisors, franchisees, and suppliers. The IFA's mission is to safeguard and enhance the business environment for franchising worldwide. In addition to serving as a resource for current and prospective franchisors and franchisees, the IFA and its members advise public officials across the country about the laws that govern franchising, with the goals of promoting franchise growth and advancing the interests of franchisees, franchisors, and suppliers. The IFA is the only trade association that acts as a voice for both franchisors and franchisees throughout the United States and the world.

The IFA also supports arbitration, which many franchise systems select as an expeditious and cost-effective method of dispute resolution. The IFA submits

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[1] Letters of consent have been submitted concurrently with this filing. No counsel for any party has authored this brief in whole or in part and no person or entity, other than *amicus curiae*, its members or its counsel made any monetary contribution specifically for the preparation or submission of this brief. S. Ct. R. 37.6.

this brief as *amicus curiae* to illustrate the practical, real-world effects to which the current inconsistency in manifest disregard standards exposes national franchise systems that select arbitration.

SUMMARY OF THE ARGUMENT

The IFA urges the Court to grant the petition for certiorari in order to resolve a conflict among the Circuits that adversely affects every company that favors arbitration and does business nationwide. Since the Court's decision in *Hall Street Associates L.L.C. v. Mattel, Inc.*, 128 S. Ct. 1396 (2008), lower courts have diverged significantly over the existence and meaning of any extra-statutory grounds for vacating an arbitration award. Some courts have held that "manifest disregard of the law" is a judicially created doctrine that *Hall Street* abolished; some courts (like the Sixth Circuit in the decision below) have held that manifest disregard is a judicially created doctrine that remains intact after *Hall Street*; and some courts have interpreted manifest disregard as a judicial gloss on Section 10 of the FAA. Federal Arbitration Act, 9 U.S.C. §§ 1-16.

The current state of the law creates tremendous uncertainty about the finality and cost-effectiveness of arbitration – uncertainty that is especially problematic for national franchise systems that rely on arbitration. Franchisors select arbitration as an expeditious, efficient and cost-effective means of

resolving disputes, but they currently do not receive those benefits uniformly across the country. These inappropriate variations in the law governing enforcement of arbitration awards significantly undermine the FAA's purpose of establishing "a national policy favoring arbitration of claims that parties contract to settle in that manner." *Vaden v. Discover Bank*, 129 S. Ct. 1262, 1271 (2009) (citations and quotation marks omitted).

Coffee Beanery v. WW, LLC, 300 Fed. Appx. 415 (2008), is an appropriate candidate for this Court to resolve the unanswered questions in the wake of *Hall Street*. Granting the petition also provides an opportunity to reaffirm this Court's decision in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), and to reiterate the benefits of a single, consistent national policy favoring arbitration.

ARGUMENT

I. Franchising Has a Substantial Impact on the U.S. Economy.

Franchising is ubiquitous in the United States today. Respected names like Hilton, Holiday Inn, McDonald's, Avis, and Wendy's are in the franchise business, and franchising has become a major factor in the U.S. economy.

In 2008, PricewaterhouseCoopers published a study of economic data from 2005 that measured

franchising's direct and indirect impact on jobs and output in the American economy. According to this study, franchised businesses generate jobs for 21 million Americans, with an annual economic output of $2.3 trillion, or 11.4 percent of total private U.S. Sector Output. 2 Nat'l Econ. Consulting, The Economic Impact of Franchised Businesses 6-7 (2008).[2] The study also concludes that franchising continues to grow faster than other businesses. *Id*.

II. Many Franchise Systems Rely on Arbitration as a Cost-Effective and Efficient Means of Resolving Disputes.

Many franchise systems employ arbitration as an efficient and cost-effective method of resolving disputes. A recent study comparing data from major franchisors over a period of eight years (from 1999-2007) found that 43-45% of franchise agreements contained an arbitration clause. *See* Christopher R. Drahozal & Quentin R. Wittrock, *Is there a Flight from Arbitration?*, 37 HOFSTRA L. R. 71, 75 (2008) (hereinafter "Drahozal & Wittrock"). Arbitration is attractive to franchised businesses because it provides finality and certainty while resolving disputes quickly and efficiently. This is particularly important in franchise systems where disputes often arise over the course of the long-term contractual relationships between franchisor and

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[2] *Available at* <http://www.franchise.org/uploadedFiles/Franchisors/Other_Content/economic_impact_documents/EconomicImpactVolIIIpart1.pdf.>.

franchisees. It benefits the particular franchisor-franchisee relationship and the entire franchise system to resolve such disputes quickly and economically, so that the parties can put the dispute behind them and continue with the business of the franchise. As this Court has recognized, arbitration can reduce the costs of resolving disputes and provide much-needed finality faster than litigating in court. *See, e.g., Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 280 (1995) (arbitration is "usually cheaper and faster than litigation; it can have simpler procedural and evidentiary rules; it normally minimizes hostility and is less disruptive of ongoing and future business dealings among the parties; it is often more flexible in regard to scheduling of times and places of hearings and discovery devices") (citations omitted). An added benefit is the ability to select an arbitrator with some expertise in franchising or the relevant industry, which can further streamline the evidentiary and decision-making process. *See, e.g., Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 633 (1985) ("adaptability and access to expertise are hallmarks of arbitration. The anticipated subject matter of the dispute may be taken into account when the arbitrators are appointed . . . "). Arbitration's efficiency and cost-effectiveness benefit both franchisor and franchisee, as well as the entire franchise system. *See* Christopher R. Drahozal & Keith N. Hylton, *The Economics of Litigation and Arbitration: An*

Application to Franchise Contracts, 32 LEGAL STUD. 549, 581-82 (2003).[3]

III. The Current Circuit Split Threatens to Undermine the Finality and Cost-Effectiveness of Arbitration for National Franchise Systems.

As the petition details, a conflict among the Circuits has developed since this Court's *Hall Street*

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[3] There may be a misperception that franchisees do not willingly arbitrate, but are forced to accept arbitration when they execute the franchisor's standard form franchise agreement. *See* James A. Brickley, Sanjog Misra & R. Lawrence Van Horn, *Contract Duration: Evidence From Franchising* (2006), 49 J. LAW & ECON. 173 (2006) (discussing theory of the "naïve franchisee"); *see also* Arbitration Fairness Act of 2009, H.R. 1020 (111th Cong., 1st Sess., Feb. 12, 2009) (proposal to invalidate pre-dispute arbitration clauses in any consumer, employment or franchise contract). The evidence, however, does not support the theory that franchisees need protection from arbitration agreements. Instead, today's franchisees are often sophisticated multi-unit owners with bargaining power and corporate experience. *See* Drahozal & Wittrock at 87. Franchisors for different systems compete head-to-head to attract franchisees, and prospective franchisees have a wealth of information at their disposal because of federal and state pre-sale disclosure regulations, including whether the contract includes an arbitration clause. *See, e.g.*, 16 C.F.R. 436.1(q) (Franchise Disclosure Rule, Item 17) (requiring disclosure of, among other things, any provision for arbitration or mediation). Moreover, if 43-45% of franchise systems include arbitration in their standard franchise agreements, then 55-57% do not. Drahozal & Wittrock at 75. There is no evidence that prospective franchisees are choosing among franchise opportunities based upon a desire to avoid arbitration. *Id.* at 75, 97-99.

decision. *See* Petition at 3-4, 15-24; *see also* Aaron S. Bayer and Joseph M. Gillis, *Arbitration after Hall Street*, FOR THE DEFENSE 44, 47-48 (November 2008) (summarizing conflict). In the First and Fifth Circuits, manifest disregard no longer exists as a ground for vacating an arbitration award. In the Sixth Circuit, manifest disregard apparently survived *Hall Street*, according to the decision below. In the Second, Seventh, and Ninth Circuits, manifest disregard remains as a judicial gloss on Section 10 of the FAA, and can be used to vacate arbitration awards within certain (though varying) standards.

The result, as a practical matter, is that the same franchise system may be subjected to very different standards of judicial review for an arbitration award depending on where the arbitration occurred. A Tennessee franchisee who arbitrates with National Franchisor in Memphis may succeed in vacating the arbitral award based on manifest disregard of the law, under prevailing Sixth Circuit law. A Mississippi franchisee who arbitrates with the same National Franchisor in Tupelo (just 108 miles south of Memphis) will not succeed on claims of manifest disregard in the Fifth Circuit.[4] And if National Franchisor is

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[4] Although many franchise agreements select an arbitration venue (such as the franchisor's home state), the same franchisor may, in practice, arbitrate in different states, either because (1) it decided to waive a venue selection in a particular case, or (2) a court held the venue selection unenforceable. *See, e.g., Nagrampa v. MailCoups, Inc.*, 469 F.3d 1257, 1287-92 (9th Cir. 2006) (*en banc*). At least one franchise agreement of a leading franchisor selects the franchisee's state as the venue for arbitration. Drahozal & Wittrock at 109.

defending against manifest disregard challenges to awards in arbitrations conducted in multiple Circuits, it will face a variety of different tests and varying possibilities of an award being vacated. This patchwork of rules is inconsistent with the FAA's uniform, "national policy favoring arbitration," *Vaden v. Discover Bank*, 129 S. Ct. 1262, 1271 (2009) (internal citation and quotation marks omitted), and unworkable for a national company (franchised or otherwise) that selects arbitration as a means of dispute resolution.

Further, different franchise systems that arbitrate in different states will have different standards apply to their arbitration awards. The inconsistent body of law may lead to contractual forum shopping for arbitration. Franchise agreements and other commercial contracts may increasingly select arbitration venues in the First and Fifth Circuits, where they can be assured of some finality at the close of an arbitration. Federal arbitration law is supposed to be uniform: it should not be the source of such inappropriate incentives for important commercial decisions.

There is no reason to believe that the disharmony among the Circuits on manifest disregard will resolve itself without this Court's intervention. In the meantime, the benefits of arbitration for national franchise systems and other large businesses will continue to be undermined. For these reasons, the Court should grant the Coffee Beanery's petition so it can resolve the post-*Hall Street* Circuit split and promote a uniform and consistent federal policy favoring arbitration.

IV. The Time is Ripe for this Court to Resolve the Proper Bounds of Any Manifest Disregard Standard for Vacating Arbitration Awards.

Since the Court first enunciated the manifest disregard standard in dictum in *Wilko v. Swan*, 346 U.S. 427, 436 (1953), *overruled on other grounds, Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989), it has never had occasion to elaborate on the proper bounds of a manifest disregard test. *See Hall Street*, 128 S. Ct. at 1404 ("We, when speaking as a Court, have merely taken the *Wilko* language as we found it, without embellishment") (citation omitted). Nonetheless, *Hall Street*'s holding that the FAA provides the "exclusive" grounds for vacatur of arbitration awards does not square with a manifest disregard standard outside the four corners of the FAA, 9 U.S.C. § 10. The Coffee Beanery's petition provides an ideal opportunity for the Court to clarify, once and for all, the appropriate bounds of any continuing manifest disregard standard.

This is an important issue because the possibility of manifest disregard review may decrease the efficiency and cost-effectiveness of arbitration as a means for resolving disputes. A recent study concluded that the manifest disregard standard "wastes more judicial resources in reviewing awards than any other standard." Michael H. LeRoy & Peter Feuille, *Happily Never After: When Final and Binding Arbitration Has No Fairy Tale Ending*, 13 HARV. NEGOT. L. REV. 167, 189 (2008) (summarizing statistics showing that

manifest disregard is argued frequently and seldom successful). The study found that "[i]nconsistent approaches over the manifest disregard standard appear to spur the surprising popularity of this basis for challenging awards," *id.* at 203, and that "court review of arbitration is rapidly growing even though the chance of overturning an award is very poor." *Id.* at 205. The possibility of vacatur for manifest disregard also threatens arbitration's essential benefits of speed, cost-effectiveness and efficiency; to guard against claims of manifest disregard in post-arbitration motions, arbitrators may become more like judges, permitting expansive discovery and issuing lengthy, detailed opinions.[5] In short, maintaining the possibility of vacatur under the manifest disregard standard likely increases the overall costs of arbitration significantly, for very little practical effect.

Manifest disregard also provides an opportunity for parties to abuse the post-arbitration process by moving to vacate an award – despite slim chances of

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[5] *See, e.g.*, Amy J. Schmitz, *Ending a Mud Bowl: Defining Arbitration's Finality Through Functional Analysis*, 37 GA. L. REV. 123, 159 (2002-03) ("arbitration procedures subject to substantive review necessarily must be 'judicialized,' meaning they must incorporate formal judicial procedures that add significantly to the delay and expense of an arbitration hearing"); *id.* at 160-61 ("as the line between arbitration and litigation fades due to expanded judicial review of awards, arbitrators are likely to spend less time focusing on efficient resolution of disputes and more time producing court-like records created to withstand substantive appeals").

victory – in order to delay paying the award or force a more favorable settlement. The party that prevailed in arbitration may not have the resources to defend time-consuming motions to vacate. One example of this unfairness arose in *NetKnowledge Technologies, L.L.C. v. Rapid Transmit Technologies*, 2007 WL 518548 at *3-5 (N.D. Tex. 2007), *aff'd*, 269 Fed. Appx. 443, 444 (5th Cir. 2008), where motions to vacate based on manifest disregard forestalled payment of the arbitrator's $3 million award more than two years. The prevailing party at the arbitration, a company named WaKuL, lacked the resources to defend the post-arbitration litigation and persevered to confirm the award only with the help of hedge fund investors, who fronted the attorneys' fees in exchange for a share of the award. *See* Jonathan D. Glater, *Investing in Lawsuits, for a Share of the Awards*, NEW YORK TIMES, June 3, 2009 (noting that "[t]he lawyers in the case received a total of more than $650,000"). Having bargained for the efficiency and finality of arbitration, WaKuL instead got mired in lengthy and expensive litigation that required it to turn to third-party investors, all because of an allegation that the arbitrator acted in manifest disregard of the law.

Finality and freedom from judicial interference are central to the arbitration process, and that is what parties bargain for when they enter arbitration agreements. *See Hall Street*, 128 S. Ct. at 1405 (highlighting the "national policy favoring arbitration with just the limited review needed to maintain arbitration's ***essential virtue of resolving disputes***

straightaway" and rejecting arguments that might "open[ ] the door to the full-bore legal and evidentiary appeals that can render informal arbitration merely a prelude to a more cumbersome and time-consuming judicial review process . . . and bring arbitration theory to grief in post-arbitration process.") (emphasis added; citations and punctuation omitted). Allowing courts to review an arbitral award based on a flexible and nebulous manifest disregard standard – even if only in certain Circuits – threatens to undermine the core feature of final and binding arbitration.

For these reasons, the Court should grant the petition for certiorari and resolve the proper bounds of any continuing manifest disregard standard for vacating arbitration awards.

V. The Sixth Circuit Decision Also Conflicts With this Court's Precedents.

The decision below overlooked decades of this Court's precedents when it vacated the arbitration award and remanded for the parties to litigate their dispute. Concluding that respondent "should not be bound by the arbitration provisions of the agreement which it was fraudulently induced into signing," the Sixth Circuit remanded for respondents to "seek appropriate relief in a court of law." 300 Fed. Appx. at 421 (Pet. App. 15). There is no evidence that the Coffee Beanery's alleged failure to disclose/fraudulent inducement related specifically to the arbitration

clause. This Court held over 40 years ago, that the FAA "does not permit the federal court to consider claims of fraud in the inducement of the contract generally." *Prima Paint*, 388 U.S. at 403-04. *See also Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 445 (2006) (same). The Sixth Circuit's decision to invalidate the arbitration clause based on fraud in the underlying contract flies in the face of well-established law.

Many commentators have noted a renewed hostility to enforcing agreements to arbitrate. *See, e.g.*, Steve J. Burton, *The New Judicial Hostility to Arbitration: Federal Preemption, Contract Unconscionability, and Agreements to Arbitrate*, 2006 J. DISP. RESOL. 469 (2006); *Nagrampa v. MailCoups, Inc.*, 469 F.3d 1257 (9th Cir. 2006) (*en banc*) (invalidating arbitration clause in franchise agreement as unconscionable). That hostility usually appears at the front end of a dispute, when a court is considering the enforceability of an agreement to arbitrate in deciding a petition to compel arbitration or a motion to stay litigation in favor of arbitration. In contrast, here, the Sixth Circuit invalidated the arbitration clause ***after*** the parties had already submitted the dispute to arbitration, presenting volumes of evidence and testimony over the course of eleven hearing days. The finality of arbitration is meaningless if, after four years of legal battles including a lengthy arbitration, an appellate court can suddenly and without

justification decide that the issue should never have been arbitrated and remand for a "do over" in court.

CONCLUSION

The Coffee Beanery decision is an appropriate vehicle for this Court to resolve the post-*Hall Street* conflict among the Circuits and clarify the proper bounds of any continuing "manifest disregard" standard for reviewing arbitration awards. The case also provides an important opportunity for the Court to reiterate the national policy favoring arbitration. For these reasons, *amicus curiae* The International Franchise Association respectfully asks the Court to grant the Coffee Beanery's petition for a writ of certiorari.

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Respectfully submitted,

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